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Fiscal Policy Report

Taxation and Fiscal Policy Department

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National Association of Manufacturers

January 23, 1981

SUBJECT: A BUSINESS PRIMER ON THE CONGRESSIONAL BUDGET PROCESS

Introduction

The business community is awakening to the critical importance of the federal budget as a significant determinant of national economic policy. During the last few years, the size of the federal budget has grown, both in terms of absolute dollars and as a percentage of the total output of goods and services (GNP) of the economy. This growth has adversely influenced the potential for constructive tax reductions and has created extraordinary pressures within money markets as the federal government finances its deficits resulting from ever-increasing spending habits.

The NAM is developing a program for business, first, to understand and then to influence the federal budget process. NAM has hired Janis Moore, a former member of the Senate Budget Committee staff, as associate director of fiscal policy. The association is also forming a new Fiscal Policy Committee from NAM members committed to working in this area.

This paper is a brief description of the mechanics of the congressional budget process. It is intended to be a basic guide for those who are interested in, but have not had another opportunity to study, the workings of the Congressional Budget Act of 1974. Throughout the year, additional reports will focus on specific topics that need attention such as mandatory spending limitations, entitlement and indexed programs, off budget and credit budget items and reforms to the budget process itself. These papers will also be supplemented by timely reports on the budget process for fiscal year 1982. Interested members can call Janis Moore at 202/626-3889.

Overview

The congressional budget process for the fiscal year beginning October 1 is organized around two "concurrent resolutions on the budget" as prescribed by the Congressional Budget Act of 1974. The First Concurrent Resolution (FCR), which is adopted by May 15, merely sets <u>targets</u> for federal spending and revenues. Following House and Senate consideration of the appropriations, revenue and entitlement legislation, Congress adopts the Second Concurrent Resolution (SCR) by September 15. This includes <u>binding</u> spending and revenue totals. Once Congress has reached the spending ceiling set in the second concurrent resolution, further spending or revenue reducing legislation cannot be considered unless a new budget resolution is adopted. Third budget resolutions, however, have become quite common in the last few years.

A budget resolution consists of a list of dollar amounts allocated to 19 functions, or specific areas of spending, with each function being assigned a number, i.e., 550: Health, or 900: Interest. (See Appendix B for the full list.) While the overall spending totals are binding, these functional limits are not.

The functional classifications included in the budget resolutions are not the same as those used by the Appropriations Committees. Therefore, each functional total must be divided or "crosswalked" among the various committees that control programs within that function. Obviously, it would be easier if the Appropriations and Budget Committees' classifications coincided, and this may be one area of budget reform that will be considered by the 97th Congress.

The Budget Committees are not considered to be line-item committees, <u>i.e.</u>, they are not supposed to make fiscal decisions at the program level. Rather, their responsibility is to set the functional and overall spending totals, leaving to the authorizing and appropriating committees the decision of how and where the money is to be spent. For the Budget Committees, however, to calculate reasonable totals, some specific spend-out and growth patterns must be assumed, and historically many of these have been applied at the program level.

Finally, it is important to realize that the <u>budget resolutions do not have the force of law</u>. Rather, they are considered to be rules of the House and Senate and, as such, can be amended or waived. The Budget Act does not include any strong enforcement mechanism to support resolution totals. The reconciliation instructions included in the FCR for fiscal year 1981 have not proven to be very effective or expedient. Hopefully, work will begin early in the 97th Congress to remedy these problems and to create a process that will impose fiscal discipline upon federal budgeting procedures.

Submission of the President's Budget Request

Planning the federal government's budget is a year-round process involving the input and the expertise of both the legislative and executive branches of the government. Looking at the budget process on a calendar-year basis, it begins 15 days after Congress convenes in January, with the president's submission of a budget proposal. Although the chief executive's documents are entitled The Budget of the United States Government, they represent only his view of the direction that certain programs should take and the spending levels that should be maintained. In his calculations, the president assumes passage of specific legislative recommendations anticipated in the coming year. While Congress is in no way bound by this proposal, it serves as a useful guide to the president's priorities and goals. Included in these four or more volumes are specific spending levels for areas of national need and major programs, analyses of the economic outlook, and spending and/or cost-saving proposals. This year there will be two proposals for FY 82--the one recently submitted by President Carter and a revised version from President Reagan sometime in February.

Preparation for the First Concurrent Resolution

During the first three months of the year, the House and Senate Budget Committees hold hearings to discuss with experts the economic outlook and trends for the next five fiscal years. While witness lists for the hearings vary, they usually include an Office of Management and Budget (OMB) representative, the director of the Congressional Budget Office (CBO), the secretary of the treasury and/or a representative from the Council of Economic Advisors. At least one panel of outside, or private sector, economists usually testifies as well. If one issue requires more attention due to changes in national or international conditions, experts in that field are also requested to testify.

During this same period, each committee in the House and Senate is preparing a "March 15" letter to the Budget Committees outlining its legislative plans and anticipated funding requirements. While these reports filed by March 15 are not binding, they give the Budget Committees an idea of the Authorizing and Appropriations Committees' expected needs and programmatic direction. This information is included in the first concurrent resolution (FCR) background materials.

Mark-Up of the FCR

Following the budget hearings, the accumulation of economic data and the receipt of the March 15 letters, each Budget Committee begins preparing for mark-up of the FCR that will set federal spending targets. In the Senate, growth histories of programs or missions are developed to provide Budget Committee members with information regarding prior-year decisions and areas of excessive or limited growth. Lists of potential savings or increases over current law are given. (Current law does not assume any discretionary adjustments for inflation in spending or program levels.) The senators vote to determine which options they wish to include or delete, and functional totals are derived by adding or subtracting these policy options from the current law base.

In the House, the chairman of the Budget Committee develops a budget proposal and submits it to the other members of the committee. His proposal includes policy assumptions and mission, functional and overall spending totals. These totals are compared to the president's budget proposal, which serves as the base. The full Budget Committee then meets to discuss any proposed revisions to the "chairman's mark." Both the House and Senate Budget Committees are expected to present a first concurrent resolution to their respective house by April 15.

Here, a major difference between House and Senate procedures creates a large problem when the two houses meet at the conference table to work out a mutually acceptable budget. Historically, the Senate Budget Committee has based its economic assumptions on the information and forecasts provided by CBO. The House, on the other hand, has more often than not chosen to modify the president's economic assumptions. Obviously, this creates dissimilar budget totals due to the inherent differences in the basic assumptions. Even if the two committees end up with the same aggregate budget totals, vast differences still exist at the functional level, making comparison of these totals difficult. Many times, conference totals have been adopted with each house assuming different funding levels for specific programs. Ultimately, the authorizing and appropriations committees in both houses must work out these problems.

House and Senate Consideration of the FCR

Before debate can begin in the House, the Rules Committee must grant a rule allowing the FCR to be brought to the floor. Technically, consideration of the proposed totals can begin any time after the 10th working day following availability of the Budget Committee's report. General debate on the FCR is limited to 10 hours, equally divided between the majority and minority parties.

Debate in the Senate on the proposed FCR and any amendments is limited to 50 hours, also equally divided between the majority and minority leaders or their designees. (Usually the chairman and ranking minority member of the Budget Committee manage the debate.) Debate on amendments is limited to two hours, and consideration of any amendment to an amendment is limited to one hour. Non-germane amendments are not in order.

In the last few years, House passage of the proposed FCR and subsequent conference reports has been very difficult because of intense disagreement occurring between and among parties. Republican members have traditionally opposed the overall spending totals, deeming them excessive. Yet, with the more conservative policies presumably mandated in the last election, there may be more unanimity on the lower spending totals.

Following passage of the FCR in both houses, conferees meet to work out a compromise between the two proposals. Besides the differing economic assumptions discussed above, other subtle differences must be considered at the conference table. Historically, the Senate has maintained higher defense levels, while the House has favored social and income security programs. Compromise is usually reached when the House agrees to a higher defense number in return for Senate acceptance of increases for social spending. Once an acceptable compromise is reached, the conferees report the new totals back to their respective house.

Consideration of the conference report in the House is limited to five hours, equally divided between the two parties. In the Senate, debate is limited to 10 hours, equally divided between the majority and minority leader or their designees (again usually the chairman and ranking minority member of the Budget Committee). Amendments in disagreement are allowed 30 minutes' debate. Action on the conference report is to be completed by May 15.

Important Aspects of a Budget Resolution

Every concurrent resolution conference report is accompanied by a joint explanatory statement that must include an estimated allocation of the appropriate budget authority (BA) and outlays (O) for each committee of the House and Senate that has jurisdiction over the legislation providing the new BA. These allocations must be based on the totals included in the resolution. Budget authority is the authority to spend in a specific year or in future years, while outlays represent the actual spending for a specific year. If, for example, an aircraft carrier is authorized to be built at a cost of $2 billion and only $500 million will be spent on first-year construction costs incurred in 1981, total budget authority for the project will amount to $2 billion. Outlays for 1981 will total $500 million. In some instances, outlays for a particular function of the budget may be higher than budget authority. In such cases, the higher level of outlays is attributable to budget authority granted in previous years.

As soon as practicable after a concurrent resolution has been agreed to, the House and Senate Appropriations Committees must consult with one another and subdivide among their subcommittees their allocation of BA and O provided in the joint explanatory statement. Every other committee of both houses that received an allocation must also confer and subdivide its allocation among the subcommittees or programs within its jurisdiction. The Appropriations Committees and all other affected committees then report these subcommittee allocations to their respective houses. These allocations are an important part of the process. If a committee reports an entitlement bill that exceeds its budget authority allocation, the legislation is immediately referred to the Appropriations Committee because the excess spending will have to be provided from appropriations funds. The Appropriations Committee may either allow the bill to be considered as it is or report it with an amendment which limits the total amount of new spending authority. Obviously, this extra referral has the potential to delay or eliminate a legislative proposal.

Authorizing and Appropriations Action

May 15 is also the deadline for committees to report all authorizing legislation, including five-year cost estimates prepared by CBO. This deadline was established to allow the Appropriations Committees time to consider authorizing requests and to ensure that appropriations bills are not held up awaiting passage of necessary authorizations. Procedures, however, are provided in the Budget Act that waive this deadline and allow consideration of authorizing legislation reported after May 15.

Final passage of the FCR is critical since Congress cannot consider any legislation that provides new budget authority, increases or decreases revenues, or increases or decreases the public debt limit prior to its adoption, unless the Budget Committees have granted a waiver.

After the FCR has passed, individual appropriations bills usually move first to the floor of the House for consideration. (While the Constitution specifically provides that any legislation affecting revenues must be considered by the House of Representatives first, it is unclear if this also holds true for spending legislation. Traditionally, however, the House initiates appropriation action.) Each of these bills has been previously marked up in subcommittee and has been reviewed and revised by the full Appropriations Committee prior to floor action. Similar procedures are followed on the Senate side, after which conferences are held to deal with differences existing between the two versions.

Entitlement legislation follows a similar course. The Budget Act, however, specifies that entitlements cannot become effective before the start of the next fiscal year. The intent is to make them fully subject to any reconciliation process.

The deadline for action on all appropriations and spending bills is the seventh day after Labor Day. Failure to meet this deadline requires enactment of a continuing resolution to fund agencies and programs from October 1 (the start of the new fiscal year) to final passage of the necessary appropriations bills.

Budget Reviews and Re-Estimates

As the House and Senate progress through budget deliberations, the president submits to Congress two updates of his budget proposal--one in April and another in July. These updates include re-estimates based on economic and/or legislative changes, which may have occurred since his last budget submission, and re-evaluations of program beneficiary levels. Estimates included in the president's July update, or Mid-Session Review, are weighed heavily during consideration of the second concurrent resolution (SCR).

The Congressional Budget Office (CBO) also submits a report on or before April 1 to both Budget Committees for the next fiscal year. (This report is usually filed in February because April is too late in the budget process for the information to be useful.) The report must include alternative levels of total revenues, total budget authority, total outlays (with related surpluses and deficits) and levels of tax expenditures under existing law, taking into account projected economic factors and changes based on proposals in the president's budget. CBO also provides a midyear report, usually in July, on the economic outlook to assist Congress in its deliberations on the SCR. This includes revisions of the April forecast, along with re-estimates of the policies included in the FCR. The report gives Congress the opportunity to see what the spending levels would be if no changes were made in the FCR assumptions. Armed with these two reports, the Budget Committees begin preparing for mark-up of the SCR.

SCR Preparation and Mark-Up

Starting in July, the Budget Committees set up hearings to receive testimony on changes in the economy since their last hearings, including economic forecasts for the next five fiscal years. Again, the director of CBO usually appears to discuss CBO's midyear economic report. A representative of the executive branch appears to discuss the president's Mid-Session Review. And outside economists are invited to provide private-sector views of potential changes on the economic front. As in the preparations for the FCR, if an aspect of the budget demands special attention, experts in that field will also be called to testify.

Generally, preparation for the SCR is not as extensive as that required by the FCR. Totals are re-evaluated only in terms of economic changes, re-estimates of costs of existing programs and the progress of spending legislation in Congress since the FCR. The Senate Budget Committee again marks up from current law and emphasis is placed on CBO's midyear re-estimates for each mission. Options for changes in current law are still presented, but fewer programmatic changes are contemplated or accepted. After the Budget Committee has reported out a resolution, it goes before the full Senate for its consideration.

In the House, the chairman of the Budget Committee again prepares a second concurrent budget proposal that he presents to the other members of his committee for discussion and possible amendment. After any necessary revisions have been made, the committee reports its version of the SCR to the rest of the House.

House and Senate Consideration of the SCR

Time limitations and Rules Committee procedures for the SCR are the same as those for the FCR, except that debate in the Senate is limited to 15 hours instead of 50 hours. When an SCR has been passed by both houses, conferees are chosen to settle the differences that exist between the two versions. SCR conferences in the last few years have been slow and agonizing, with deliberations continuing for many weeks past the statutory September 15 deadline. Defense and social spending totals continue to be major points of contention, along with the differing economic assumptions underlying House and

Senate totals. Once a compromise has been accepted, both committees take the conference agreement back to their houses for adoption.

Unlike the FCR, the SCR sets binding totals and it is considered out of order to take up any legislation that provides additional budget authority, new spending authority or reduced revenues if enactment would breach the BA and O totals or cause the revenues to fall below the amounts specified in the SCR. It should be noted that, while the Senate includes the effects of future spending requirements to determine the point at which spending will breach this ceiling, the House considers only legislation that has actually been passed. Obviously, the Senate computation is a more accurate indication of the anticipated spending level in any given year.

> Example: While the Senate figures would include a cost-of-living adjustment (COLA) for the veterans' compensation program, even without final passage of the legislation, the House figures would not. Historically, however, such cost-of-living adjustments are made annually even though the program is not automatically indexed.

Congress has the ability to revise its budget totals at any time, and third budget resolutions are becoming common. Due to the overly optimistic assumptions included in the FY 81 SCR, a third resolution will be required this spring to fund many programs through October 1.

Reconciliation

The reconciliation process, which was used for the first time in FY 81, is a procedure provided in the Budget Act by which Congress can instruct designated committees to report legislation that changes existing law to bring spending into line with the totals established in the SCR. The Budget Act also states that the first concurrent resolution "may also require any other procedure which is considered appropriate to carry out the purposes of this Act". It was under this provision that reconciliation instructions were included in the first concurrent resolution for FY 81. The sense of the Budget Committee members was that attaching the reconciliation instructions to the FCR allows more time for committee action and enactment of savings and revenue-raising legislation. Under reconciliation, 10 Senate and eight House committees were ordered to report legislation that would reduce outlays by $6.4 billion and increase revenues by $4.2 billion. The committees reported their recommendations to their Budget Committees, which then incorporated them into two bills in the Senate and one omnibus reconciliation bill in the House. Both houses passed different versions of the bill, and a 102-member conference committee met to work out the differences. On December 3, a reconciliation bill was adopted that included $4.6 billion in spending reductions and $3.6 in increased revenues.

Adjournment of the House and Senate

Finally, according to the Budget Act, neither the House of Representatives nor the Senate may adjourn sine die unless action has been completed on the latest concurrent resolution and any reconciliation bills or resolutions. While ways exist to circumvent this requirement, it is important to note that failure to pass the second concurrent resolution for FY 81 was a major reason for the lame-duck session of the 96th Congress.

Although the budget process began with passage of the Budget Act in 1974, it is only in the last few years that it has begun to attract attention. This attention, however, has been accompanied by sharp criticism for delays in timing and inaccuracies in economic forecasts that have plagued the process. Due to these problems, and a new administration and Republican majority in the Senate, new efforts can be expected in the 97th Congress to improve enforcement procedures within the budget process and ultimately to make Congress more accountable for excessive federal spending.

APPENDIX A

Federal Budget Timetable

On or Before:	In Theory	In Practice FY 1981
15th day after Congress Convenes	President submits his budget message	President Carter submitted his first FY 81 proposal on January 28
March 15	Committees and Joint Committees submit spending and revenue estimates to the Budget Committees	
April 1	Congressional Budget Office (CBO) submits its annual report to the Budget Committees	CBO submitted its report in two parts, on January 29 and February 7 respectively
April 15	Budget Committees report First Concurrent Resolution (FCR)	HBC* reported an FCR for FY 81 on March 26 SBC** reported its FCR for FY 81 on April 9
May 15	Final day for reporting of legislation authorizing new budget authority	
May 15	Congress completes action on First Concurrent Resolution	Senate and House adopted H. Con. Res. 307, the FCR for FY 81, on June 12
May 15	Congress begins floor action on individual spending and revenue measures	
7th day after Labor Day	Congress completes action on individual spending measures	As of September 8, Congress had not passed <u>any</u> of the 13 appropriations bills
September 15	Congress completes action on Second Concurrent Resolution (SCR)	SBC reported its SCR recommendations on August 27. HBC reported its recommendations on November 13. Final passage of H. Con. Res. 448, the SCR for FY 81, occurred on November 20
September 25	Congress completes any reconciliation measures	H.R. 7765, the reconciliation instruction attached to the <u>FCR</u>, passed December 3
October 1	New fiscal year begins	As of the first day of FY 81, Congress had <u>not</u> passed an SCR, the reconciliation measure or 10 of the 13 appropriation bills
November 20		House and Senate adopted SCR
December 3		House and Senate adopted reconciliation measure

* House Budget Committee
** Senate Budget Committee

APPENDIX B

Functions of the Budget

050: National Defense

150: International Affairs

250: General Science, Space, and Technology

270: Energy

300: Natural Resources & Environment

350: Agriculture

370: Commerce and Housing Credit

400: Transportation

450: Community & Regional Development

500: Education, Training, Employment, and Social Services

550: Health

600: Income Security

700: Veterans Benefits and Services

750: Administration of Justice

800: General Government

850: General Purpose Fiscal Assistance

900: Interest

920: Allowances

950: Undistributed Offsetting Receipts

APPENDIX C

Senate Budget Committee Members (22)

Republicans (Majority): 12

Chairman:
Pete Domenici (NM)

William Armstrong (CO)

Mrs. Nancy Kassebaum (KS)

Rudy Boschwitz (MN)

Orrin Hatch (UT)

John Tower (TX)

Mark Andrews (ND)

Steven Symms (ID)

Charles Grassley (IA)

Robert Kasten (WI)

Dan Quayle (IN)

Slade Gorton (WA)

Democrats (Minority): 10

Ranking Minority Member:
Ernest Hollings (SC)

Lawton Chiles (FL)

Joseph Biden (DE)

Bennett Johnston (LA)

Jim Sasser (TN)

Gary Hart (CO)

Howard Metzenbaum (OH)

Donald Riegle (MI)

D. Patrick Moynihan (NY)

J. James Exon (NE)

APPENDIX C (continued)

House Budget Committee Members (30)

Democrats (Majority): 18

Chairman:
James Jones (OK-1)

Jim Wright (TX-12)

David Obey (WI-7)

Paul Simon (IL-24)

Norman Mineta (CA-13)

Jim Mattox (TX-5)

Stephen Solarz (NY-13)

Timothy Wirth (CO-2)

Leon Panetta (CA-16)

Richard Gephardt (MO-3)

Bill Nelson (FL-9)

Les Aspin (WI-1)

W. G. Hefner (NC-8)

Thomas J. Downey (NY-2)

Adam Benjamin Jr. (IN-1)

Brian J. Donnelly (MA-11)

Beryl Anthony Jr. (AR-4)

Phil Gramm (TX-6)

Republicans (Minority): 12

Ranking Minority Member:
Delbert Latta (OH-5)

Ralph Regula (OH-16)

Bud Shuster (PA-9)

Bill Frenzel (MN-3)

Jack Kemp (NY-38)

James Martin (NY-9)

Paul Trible Jr. (VA-1)

Ed Bethune (AR-2)

Mrs. Lynn Martin (IL-16)

Albert Lee Smith (AL-6)

Eugene Johnston (NC-6)

Ms. Bobbi Fiedler (CA-21)

Chamber of Commerce
of the United States

Congressional Action

February 20, 1981
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IN THIS EDITION

- o Highlights Of The Reagan Economic Program
- o A Message To The U.S. Chamber Membership
- o Why Supply-Side Tax Cuts Aren't Inflationary

A bulletin to help members of the U.S. Chamber's Congressional Action System keep track of what Congress is doing and communicate with their Senators and Representatives on national legislative issues that affect their businesses, their employees, and their communities.

"AMERICA'S NEW BEGINNING: A PROGRAM FOR ECONOMIC RECOVERY"

On February 18, President Reagan presented to Congress a comprehensive program for curing the ills that now plague the nation's economy. He has named his program "America's New Beginning: A program for Economic Recovery."

The President would redirect the role of the federal government by:

- cutting federal spending and taking other related measures to reduce the budget deficit;
- reducing personal and business taxes; and
- lessening the burden and intrusion of the federal establishment.

The President believes that if his three-part program were enacted promptly by Congress, it would:

- reduce — and ultimately eliminate — inflation, "which for the first time in 60 years has held to double digit figures for two years in a row";
- reduce the tax burden on the American taxpayer, which "in the last five years . . . for the average family increased 67%";
- reduce the nonproductive burden imposed by the federal establishment, particularly through its regulations;
- reduce the size and role of the federal government, and its intrusion in decisions that could better be made by individuals, businesses, and state and local governments;
- reduce interest rates — which now are at "absurd" levels of more than 20% — for credit purchases and borrowing of money, by reducing the federal borrowing necessary to cover massive deficits, which have swollen the national debt to the "incomprehensible" figure of nearly $1 trillion; and
- increase real incomes — "which, after adjusting for inflation, have declined five percent over the past five years" — by spurring capital investment and enhancing productivity.

GOVERNMENT SPENDING REFORM

In his February 18 address to the House and Senate, and a more detailed "Budget Reform Plan," the President proposed major steps toward redirecting government spending. Those proposals include:

- cutbacks in lower-priority federal activities;
- sharply constrained overall federal spending; and
- dramatic shifts in internal budget priorities.

Major features of the President's government spending reform program include:

- a $41.4 billion reduction in fiscal-82 outlays, compared to the current policy base, together with $2 billion in increased user charges and $5.7 billion in "off-budget" outlay reductions, for a total of $49.1 billion in fiscal-82 spending savings and revenue increases;
- a dramatic decline in federal spending growth, bringing the fiscal 1979-81 average annual increase in spending of 16% down to 7% over the next several fiscal years;
- a steady reduction in the federal deficit, resulting in a "modest" surplus in fiscal-84 and thereafter;
- a first comprehensive overhaul in more than a decade of the nation's overgrown $350 billion "entitlements" system (Proposed revisions of food stamp, extended unemployment benefits, trade adjustment assistance, various "secondary" Social Security benefits, student loans, Medicaid and other "entitlement" programs would save $9.4 billion in fiscal-82);
- a substantial cutback, or actual elimination, of non-essential or ineffective federal programs, including CETA public service jobs, AMTRAK, energy technology commercialization programs, impact aid and federal support for the arts;
- a consolidation of nearly 100 narrow categorical grant programs into a few flexible block grants for state and local support of education, health and social ser-

A Message To The Membership

The Board of Directors of the U.S. Chamber of Commerce has endorsed, in total, President Reagan's economic program of extensive spending and tax cuts. We believe that adoption of these proposals, which are outlined in this edition of *Congressional Action*, is essential to rebuilding America.

To succeed in his sweeping effort to revitalize our economy the President must have working with him a unified coalition of Americans willing to rise up above self-interest and urge the Congress to get on with this vital job.

Business must set the example and work aggressively to develop and participate in such a coalition. After all, it is business, more than any other group, that for years has pointed to the grave dangers of government going out of control.

For business now to cater to its own self interests and seek exemptions of any kind from the President's program of budget cuts would not only destroy our credibility, but also seriously impair the united effort that will be needed nationwide to press the Congress to approve the President's program.

You can play a vital role in helping the President forge a "New Beginning" for America! As a business leader, you can help rally constituent support for the President's program, not only among your employees, but also among your fellow businessmen and women and other important groups in your community.

In doing this, we are well aware that you will face enormous resistance from those who are desperate to preserve their special benefits. But if we, as business leaders, resist all temptations to seek exceptions for ourselves, we can exert the leadership of integrity that could significantly affect the outcome of this crucial effort.

As businessmen and women, we have waited a long time for this opportunity to begin rebuilding America and, finally, to turn our nation's present, disastrous, economic course around.

We must not miss this chance.

C. William Verity, Jr.
Chairman
Chamber of Commerce of the U.S.

vices (savings by fiscal-83 would exceed $4 billion);

- a sharp reduction in direct federal subsidies for synthetic fuels development, Export-Import Bank activities and the dairy industry, along with a substantial stretch-out of construction funding for highways, airports, sewage treatment plants and water projects; and
- an increase in user fees for barge operators, air system users and commercial and recreational vehicles.

In all, on February 18, the President proposed 83 major policy and program actions to achieve spending savings.

Those major proposals were made to Congress on that date to allow the House and Senate to meet its schedule for "reconciling" fiscal-81 spending and setting the course for fiscal-82 outlays. The President will submit a fully revised fiscal-82 budget to Congress on March 10, 1981.

That revision will propose the additional fiscal 1981-82 spending reductions needed to achieve the Chief Executive's goal of a $41.4 billion cut in fiscal-82 outlays, below the current policy base.

TAX REFORM

On January 18, the President also proposed a comprehensive plan for reducing individual and business taxes, which presently are at an all-time high level, by $8.9 billion in fiscal-81, $53.9 billion in fiscal-82 and, finally, by $124.7 billion by fiscal-86.

Individual Tax Relief — The tax burden on individuals has increased dramatically over the past few years, as double-digit inflation has pushed working Americans into higher tax brackets (so-called "bracket-creep") and as Social Security tax rates have increased. This has reduced the incentive to work and the ability to save.

To reverse that trend, the President proposed that individual marginal income tax rates be reduced by 10%, effective on July 1, 1981; by a second 10%, effective on July 1, 1982; and by a third 10%, effective on July 1, 1983.

The net effect of this so-called "Kemp-Roth" tax cut — named after its chief congressional proponents, Representative Jack Kemp (R-N.Y.) and Senator William Roth (R-Del.) — would be a five percent reduction in 1981 individual taxes, a 15% reduction in 1982 taxes, a 25% reduction in 1983 taxes and a 30% reduction in 1984 taxes.

The President believes that such cuts not only would provide individuals with greater incentives for productive employment and savings, but also would make tax

Continued on page 7

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CA Special Report

THE CONGRESSIONAL BUDGET GAME FOR 1981
A Guide To The Rules, Dates, Players, and Jargon

by Kenneth D. Simonson
Tax Economist, U.S. Chamber
Tax Policy Center

The hardest fought battle in Congress this year undoubtedly will be over reducing the growth in government spending.

President Reagan fired the first salvo on February 18, when he asked Congress to reduce outlays by $4.4 billion in fiscal 1981 (the 12-month period which ends on September 30, 1981) and by $41.4 billion in fiscal 1982 (which starts this coming October 1).

The need for spending restraint at this time is obvious.

Federal expenditures now account for about 23 percent of the Gross National Product (GNP), a higher percentage of the total goods and services the nation produces than in World War II.

This year will be the 12th year in a row and the 20th year in the past 21 years in which the federal government has operated in the "red."

Business has an especially high stake in restraining spending for two reasons:

- sorely needed tax relief for businesses and individuals — including capital cost recovery (accelerated depreciation) and individual rate cuts — almost certainly would be delayed or, at least, reduced in size if spending were not slowed down promptly; and
- the high deficits caused by excessive spending mean that government is constantly forced to borrow, driving up interest rates for business borrowers and, worse yet, "crowding out" businesses which can't compete with government as a credit risk.

But while politicians, business people, and consumers all agree — in principle — that we must now begin to cut federal spending, problems arise in progressing from the principle of spending restraint to particular spending cuts.

Federal expenditures are not addressed in one simple appropriation bill that sets an overall outlay total — which could be adjusted due to whim or necessity. Instead, total government outlays are the end-product of an intricate process, which business must understand if it is to be effective in helping to control spending.

Understanding the Budget Process

The budget process for the coming fiscal year begins in January, when the President submits his budget requests to Congress. Those requests are made by agency, program and function, and are contained in a *single* document. But Congress deals with them in *several* different ways.

First, the Administration's spending requests are di-

Key Dates

The budget process continues all year, but certain dates will be especially important to the budget process in 1981.

Watch *CA* at these times for information on how *you* can help get Congress to lower federal spending.

Early to mid-March — Senate considers revised second budget resolution for fiscal 1981, expected to include "reconciliation" instruction to cut previously approved spending.

Before April 15 — Budget Committees report first budget resolution for fiscal 1982, including recommended size of tax and spending cuts.

Late April to May 15 — Both houses consider first budget resolution for fiscal 1982. Revised second budget resolution for fiscal 1981 and/or "reconciliation" instructions could be included in resolution.

June or July — Both houses of Congress consider "reconciliation" bill, if required by first budget resolution adopted in spring.

Before September 15 — Both houses of Congress consider second budget resolution for fiscal 1982.

vided up among various congressional committees. Each House and Senate panel must advise its respective Budget Committee, by March 15, as to how much of that spending it expects to approve for the next fiscal year, which begins on October 1.

Based on those Committee requests, plus an assessment of the political climate and short-term changes in economic conditions, the Budget Committees, by April 15, report a "first concurrent budget resolution" to the floor of each house.

This resolution sets "the appropriate level" of overall federal spending, as well as spending for each functional budget category (such as national defense, income security, etc.), revenues, and a resulting deficit or surplus.

However, this first budget resolution does not spell out specifically how the money is to be collected or spent — that is left to the tax-writing and appropriations committees.

The House and Senate are supposed to agree on this resolution by May 15. Because it is a concurrent resolution, and not a law, it does not go to the President for signature. Nevertheless, as far as Congress is concerned, this resolution carries the force of law.

No spending, revenue, or debt bill for the coming fiscal year may be taken up in the House or Senate until the first budget resolution is adopted.

By the seventh day after Labor Day (September 15, this year) Congress must complete action on all bills setting forth new spending authority for the coming year.

Also by September 15, Congress must adopt a "second concurrent budget resolution" which reaffirms or revises the levels set in its first budget resolution, in light of changed economic conditions or national priorities.

In practice, either the first or the second budget resolution also may instruct Congress to enact a "reconciliation" bill, which creates new law or amends previously enacted laws so as to bring spending or revenues, or both, into line with the amounts dictated by that budget resolution.

Such a "reconciliation" bill is supposed to be enacted by September 25, so that Congress would have completed all actions affecting the budget before the October 1 beginning of the new fiscal year.

HOW TO SPEAK "BUDGETESE"

The budget "game" has its own lingo. Here are a few of the important terms:

Appropriation — A law telling a government agency how much money it may spend, and for what purposes, usually preceded by an authorization.

Authorization — A law which defines the overall purpose and maximum size of an agency or program. Usually followed by an appropriation, to specify the amount that may be spent each year.

Concurrent resolution — A resolution passed by both houses of Congress, but not requiring the President's signature.

In the case of the budget, there must be at least two, to be adopted by May 15 and September 15, setting forth appropriate levels of spending, taxes, surplus or deficit, and national debt for the coming fiscal year.

In practice, a "revised" second resolution is often needed after the fiscal year has begun, because economic conditions or national priorities have changed.

Continuing Appropriation — A law allowing an agency to continuing spending at a specified rate until a certain date or until its regular appropriation becomes law.

Often needed when Congress or the President do not approve the agency's appropriation by the start of the fiscal year.

Entitlement — A program, such as unemployment compensation or Social Security, that requires payments to all individuals who meet its eligibility standards.

The law establishing the entitlement may designate the rate of payment and eligibility criteria, but not the number of people who qualify, thus making its cost uncertain.

Fiscal Year — The budget year, running from October 1 to September 30.

Outlays — Actual expenditures, as contrasted to appropriations, which designate how much may be spent.

Reconciliation — A law creating new law or revising previously enacted spending or tax laws, passed as a result of a "reconciliation" instruction which Congress may include in a concurrent budget resolution.

GROWTH OF FEDERAL SPENDING, TAXATION AND INDEBTEDNESS SINCE FISCAL 1970

(Amounts in billions of dollars)

Fiscal Year	Gross National Product	Revenues		Spending		Deficit		
	Amount	Amount	% of GNP	Amount	% of GNP	Amount	Total Federal Debt	Total Debt Interest
1970	968.9	193.7	20.0	196.6	20.3	-2.8	382.6	14.4
1971	1,032.7	188.4	18.2	211.4	20.5	-23.0	409.5	14.8
1972	1,126.6	208.6	18.5	232.0	20.6	-23.4	437.3	15.5
1973	1,255.2	232.2	18.5	247.1	19.7	-14.8	468.4	17.3
1974	1,381.5	264.9	19.2	269.6	19.5	-4.7	486.2	21.4
1975	1,480.5	281.0	19.0	326.2	22.0	-45.2	544.1	23.2
1976	1,642.7	300.0	18.3	366.4	22.3	-66.4	631.9	26.7
1977	1,864.0	357.8	19.2	402.7	21.6	-44.9	709.1	29.9
1978	2,085.3	402.0	19.3	450.8	21.6	-48.8	780.4	35.4
1979	2,357.8	465.9	19.8	493.6	20.9	-27.7	833.8	42.6
1980	2,567.5	520.0	20.3	579.6	22.6	-59.6	914.3	52.5

That is how the 1974 Congressional Budget Act *says* the budget process is to work. However, in fact, that process is usually much more complex and less rigid.

Last year, the first budget resolution was not adopted until June. That resolution, for the first time in the five-year history of the new budget process, mandated enactment of a reconciliation bill. Although the various House and Senate spending committees which had to draft reconciliation provisions finished their work during the summer, the two houses did not pass a final bill until December, during the lame duck session.

The second budget resolution for fiscal 1981 was not adopted until November 20, nearly two months after the fiscal year had begun.

And several of the fiscal 1981 appropriations bills still have not been passed. Instead, agencies are operating under an omnibus "continuing resolution" which authorizes most of them to spend at the same rate as in fiscal 1980.

The Process This Year

The budget business seems certain to become even more complicated this spring.

Changing economic conditions have made the spending and revenue totals in the supposedly final second budget resolution for fiscal 1981, passed less than three months ago, obsolete. Passage of a "revised" second resolution will probably be necessary.

This revised resolution may include another "reconciliation" instruction, requiring Congress to: make further cuts in programs already approved for fiscal 1981, the fiscal year which now is nearly half over; and make spending cuts affecting fiscal 1982.

If such a revised resolution is adopted, another reconciliation bill could have to make its way through the various committees, the floor of each chamber, a conference committee, final passage and, lastly, the President's signature. (Unlike a budget resolution, which merely contains a "reconciliation" *instruction*, a "reconciliation" bill itself must go to the President — since it creates new law or changes existing laws.)

This spring, the clock also will be running on the first concurrent budget resolution for fiscal 1982, which must (at least according to the Congressional Budget Act) be adopted by May 15.

Why Spending is so Hard to Cut

Why does it take such a complicated process to achieve spending reductions?

Unfortunately, even though almost every group agrees on the desirability of spending cuts in *general*, any *specific* cut is likely to face fierce opposition from the group or groups that benefit from the affected program.

One single-interest group often can bring enough pressure to bear on Congress to protect its pet program from the wishes of those who want to cut back outlays generally.

HOUSE AND SENATE BUDGET COMMITTEES

HOUSE		SENATE	
Democrats	**Republicans**	**Republicans**	**Democrats**
James R. Jones (Okla.)	Delbert L. Latta (Ohio)	Pete V. Domenici (N.M.)	Ernest F. Hollings (S.C.)
Jim Wright (Tex.)	Ralph Regula (Ohio)	William L. Armstrong (Colo.)	Lawton Chiles (Fla.)
David R. Obey (Wis.)	Bud Shuster (Pa.)	Nancy L. Kassebaum (Kans.)	Joseph R. Biden, Jr. (Del.)
Paul Simon (Ill.)	Bill Frenzel (Minn.)	Rudy Boschwitz (Minn.)	J. Bennett Johnston (La.)
Norman Y. Mineta (Calif.)	Jack Kemp (N.Y.)	Orrin G. Hatch (Utah)	Jim Sasser (Tenn.)
Jim Mattox (Tex.)	James Martin (N.C.)	John Tower (Tex.)	Gary W. Hart (Colo.)
Stephen J. Solarz (N.Y.)	Paul S. Trible, Jr. (Va.)	Mark Andrews (N.D.)	Howard M. Metzenbaum (Ohio)
Timothy E. Wirth (Colo.)	Ed Bethune (Ark.)	Steven D. Symms (Idaho)	Donald W. Riegle, Jr. (Mich.)
Leon E. Panetta (Calif.)	Lynn Martin (Ill.)	Chuck Grassley (Iowa)	Daniel P. Moynihan (N.Y.)
Richard A. Gephardt (Mo.)	Albert L. Smith, Jr. (Ala.)	Bob Kasten (Wis.)	J. James Exon (Neb.)
Bill Nelson (Fla.)	Eugene Johnston (N.C.)	Dan Quayle (Ind.)	
Les Aspin (Wis.)	Bobbi Fiedler (Calif.)	Slade Gorton (Wash.)	
W.G. (Bill) Hefner (N.C.)			
Thomas J. Downey (N.Y.)			
Adam Benjamin, Jr. (Ind.)			
Brian J. Donnelly (Mass.)			
Beryl Anthony, Jr. (Ark.)			
Phil Gramm (Tex.)			

However, there *is* a way spending cuts can be achieved. The way to overcome such opposition is to package a potpourri of spending cuts into a single reconciliation bill.

This tactic enables Members of Congress to tell each special-interest group that it is not being singled out; that lawmakers are evenly spreading the pain of cutbacks.

Why can't Congress be completely even-handed, and enact an "across-the-board" spending cut of, say, five percent in each budget category?

An "across-the-board" categorical cut is impossible without getting into the specifics of each program in those categories.

Actually, only about one-quarter of each year's spending is subject to annual appropriations by Congress. The remainder is "uncontrollable," in that Congress must change the law that authorizes the spending before it actually can reduce that spending.

Such "uncontrollables" consist primarily of "entitlements" and expenditures to meet prior contract commitments.

"Entitlements" are payments to all individuals who qualify under a given program, such as unemployment compensation or Social Security.

Since Congress cannot accurately forecast how many persons will qualify for these benefits in a given fiscal year, it cannot accurately predict the amount of outlays needed for such a program in that year.

Thus, the only ways to cut back "entitlement" outlays are to reduce payments per individual or to tighten eligibility rules so that fewer people will qualify.

Similarly, Congress cannot reduce payments on prior contract commitments, such as multi-year construction projects, or on interest on the national debt.

Thus, an "across-the-board" spending cut winds up affecting only a small fraction of the budget, unless it is accompanied by detailed changes in laws governing spending programs.

Why can't Congress just cut fraud, waste, and abuse?

Unquestionably, federal spending includes a lot of fraud, waste and abuse. But, obviously, there is no budget item labeled "fraudwasteandabuse" which can be eliminated with a single stroke.

Instead, those problems must be uncovered by careful congressional and executive oversight, and cleared up case-by-case.

Furthermore, one person's "waste" is another's "vital program."

In summary, *there are no shortcuts to spending cuts*. And Members of Congress will be hearing from plenty of interest groups why various parts of the budget *"can't"* be cut. That's why business *must* keep sending Congress the message that spending *can* and *must* be cut — *now*!

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OPPOSITION TO TAX CUT PROPOSALS BUILDING

Surprise. It now appears that President Reagan's tax reduction proposals will meet as much, or more, resistance in Congress than his proposed budget cuts.

In the wake of the President's February 18 economic address, congressional leaders of both parties — including Democratic House Budget Committee Chairman Jim Jones (Okla.) — are predicting that most of the Reagan spending cutbacks will be approved by summer.

Those optimistic predictions are being made even in light of pressure on Congress by Washington's myriad of interest groups — thus far led by the AFL-CIO — to reject those budget cuts which would affect their pet programs.

However, formidable opposition seems to be building against the President's tax cut proposals, especially his request for an across-the-board reduction in personal income tax rates by 30% over the next three years.

The President, himself, has told reporters that the "big battle" in Congress is likely to come over tax cuts because, "There's still that belief on the part of many that a cut in tax rates automatically means a cut in revenues."

Read the commentary by U.S. Chamber Vice President and Chief Economist Richard Rahn which appears on page 8 of this *CA*. And, then, when you communicate with your Representative and Senators in support of the President's economic program, be sure to reject the notion that saving and investment producing supply-side tax cuts are inflationary.

Economic Program, Continued

shelters less attractive and, conversely, productive investments more attractive. And that, in turn, would stimulate the economy, improving productivity and creating new jobs.

Business Tax Relief — The President also proposed establishment of a new system for treating investments by business and industry — which he called the "Accelerated Cost Recovery System."

That system — which is very similar to the Capital Cost Recovery System ("10-5-3") introduced in the 96th and 97th Congress by Reps. Jim Jones (D-Okla.) and Barber Conable (R-N.Y.) — would speed up, by 40%, the time over which the cost of investments could be "written off" by businesses when calculating taxes.

Under this Presidential proposal, business property would fall into one of five write-off periods:

- **Three years** — autos, light trucks and machinery, and equipment used for research and development.
- **Five years** — other machinery and equipment, except for certain long-lived public utility property.
- **10 years** — factory buildings, retail stores and warehouses used by their owners.
- **15 years** — other non-residential buildings, such as offices and leased stores and low-income housing.
- **18 years** — other rental residential structures.

That new depreciation system, which would be effective for property acquired or placed in service after December 31, 1980 — and which would give business $9.7 billion in additional capital in fiscal-82, increasing to $59.3 billion in fiscal-86 — would improve upon the present, complex depreciation system in several ways. Specifically it would:

- substantially increase the incentive for business investments, which ultimately would increase productivity, increase real wages and sustain economic growth;
- provide the basis for "creating 13 million new jobs";
- reduce the accounting and tax planning burden on business; and
- reduce the auditing burden on the Internal Revenue Service (IRS).

REGULATORY REFORM

During his February 18 address, the President reviewed the actions he had taken since his January 20 inauguration to reduce the burden, cost and intrusion of government regulatory efforts "that are unnecessary, duplicative, inefficient, or simply not justified on the basis of benefits." Those actions included:

- January 22 creation of a Task Force on Regulatory relief, composed of seven cabinet-level members and chaired by the Vice President;
- January 29 termination of the Council on Wage and Price Stability's wage-price standards program, which had been ineffective in braking inflation and had proven burdensome and a waste of tax dollars; and
- January 29 postponement, to the extent permitted by law, of the effective dates of regulations that would otherwise have become effective before March 29, 1981, as well as a freeze on issuance of new regulations during that same 60-day period.

On February 18, the President also announced two additional actions in his continuing program to reduce unnecessary regulation. They were:

- issuance of an Executive Order designed to improve the management of the federal regulatory process; and
- integration of the goals of regulatory relief and paperwork reduction, using as a vehicle the Paperwork Reduction Act enacted by the 96th Congress.

Tax Cuts Inflationary? Experience Says 'No!'

During the last 15 years Americans have experienced ever higher levels of inflation and taxation in tandem with rising budget deficits.

Given this historical relationship, why is it so many people are determined to have us believe that any tax reduction would be dangerous now, because all tax cuts are implicitly inflationary?

Usually we are told that a choice must be made between balancing the budget and reducing taxes. It is suggested that tax reductions will automatically increase the deficit, which the Federal Reserve must then cover by printing more money, thus generating more inflation.

Not a Tax Cut

That scenario is false. To start with, it is misleading to suggest that taxpayers will be getting any real tax cut at all. Inflation, combined with recently legislated increases in Social Security taxes and oil excise taxes, and a highly progressive income tax, all limit the choice to one between a very large tax revenue *increase* or a somewhat lesser *increase*.

The assumption that Americans must choose between a balanced budget and tax reduction, because tax cuts will automatically increase the deficit and worsen inflation, is also false.

The whole idea that tax cuts are inflationary stems from a confusion of tax rates with tax revenues. The two are not identical: Inflation-swollen incomes can produce higher tax revenues even if tax rates stay the same.

The Kemp-Roth bill, which has become a core component of the Reagan administration's economic approach, would lower all marginal tax rates by 10 per cent across the board each year for three years. By cutting marginal tax rates we would be rewarding additional work relative to additional leisure, and rewarding additional saving and investment relative to additional consumption. In effect, we would be reducing the "price" of work and increasing the "price" of leisure. Incentives are the essence of supply-side economics.

What's more, since we know that higher levels of production, savings and investment would improve the rate of productivity and increase supplies of goods and services, it is ludicrous to say that cutting marginal tax rates would automatically increase the deficit and worsen inflation.

Indeed, supply-side economists are convinced that precisely the opposite is true. Every major tax-rate reduction in this century, starting with those first proposed in 1920, resulted in increased government revenues. The burden of proof is on those who oppose supply-side tax reductions to find a case when this did not occur.

The Kennedy Experience

When President Kennedy took office, the highest marginal tax rate was still above 90 per cent. In announcing his intention to cut rates across the board, he said, "Our true choice is not between tax reduction, on the one hand, and the avoidance of large federal deficits on the other . . . An economy hampered by restrictive tax rates will never produce enough revenue to balance the budget — just as it will never produce enough jobs or enough profits."

Commenting in 1965 on results of Kennedy's rate reductions, Walter Heller, who was the President's chairman of the Council of Economic Advisers, said: "What happened to the tax cut in 1965 is difficult to pin down, but . . . did it pay for itself in increased revenues? I think the evidence is strong that it did."

There are other examples of tax-rate reductions that have paid for themselves. The capital gains tax reduction passed in 1978 has led to a $1.1 billion revenue *gain*, as contrasted to a $2.7 billion revenue *loss* forecast by the Treasury.

Filing in Puerto Rico

And, the most recent example was provided by Governor Carlos Romero Barcelo in Puerto Rico, who reduced income tax rates there by 15 per cent in the last two years. Citing this case, Congressman Jack Kemp noted on the floor of the House, "They found as they reformed their tax code and lowered their rates of taxation on all individual taxpayers that not only did revenues climb by 13.5 per cent, but so did the number of people filing returns."

In other words, when tax rates are cut, individuals at the top of the income scale discover that tax shelters now offer less attractive returns, while those hiding in the underground economy find they can now engage in legitimate business activities and remain law-abiding citizens as well.

The increased economic growth that has historically resulted from reducing tax rates can work in the 1980s to reduce the demand for higher governmental spending, particularly in transfer payment programs such as unemployment compensation, food stamps, trade adjustment, welfare, and so on. Stimulating economic growth through tax reduction results in large numbers of people leaving the public dole and entering the private economy. The explosion in federal spending in recent years is a direct result of our sluggish economy, aggravated by the last administration's refusal to support general rate reductions.

Given these two beneficial effects of supply-side tax cuts — large revenue feedbacks and a lower level of government spending — it is both impossible and misleading to assume that tax-rate reductions will mean higher deficits and inflation.

Indeed, I believe reductions in marginal tax rates of 10 per cent a year for three years, combined with improved business depreciation, will increase productivity growth, reduce unemployment, and substantially mitigate inflationary pressures, while increasing Americans' real per capita incomes.

In the absence of such tax cuts, American workers will see their individual income and Social Security taxes rise by a staggering $64 billion in FY 1981 and $77 billion in FY 1982. When one considers that average real spendable earnings per worker have declined 15 per cent since 1972, tax increases of this magnitude are hardly the sort of policies needed to get this country moving again.

This commentary by U.S. Chamber Vice President and Chief Economist Richard Rahn appeared in the February 18 ***Washington Star****. It is an effective rebuttal of the traditional "Keynesian" argument that an across-the-board tax reduction would increase inflation under present economic conditions.*

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NEWSPAPER

GLOSSARY

Reconciliation. A procedure provided for in the Congressional Budget Act (P.L. 93-344) under which Congress repoens previously enacted legislation in order to change spending that would otherwise occur (or in order to increase or decrease revenues).

Reconciliation is a two step process. Congress first agrees to an instruction, as part of a budget resolution. The instruction directs one or more committees to report, by a date certain, legislation which will achieve savings in specific amounts (or specific changes in revenue levels).

If only one committee is instructed, it reports a reconciliation bill directly to the Senate. If two or more committees are instructed, they submit reports to the Budget Committee. The Budget Committee packages the legislation developed by the different committees into a single omnibus reconciliation bill, which is reported to the Senate without substantive change.

Floor debate on a reconciliation bill is limited to 20 hours, including time spent on any amendments; and amendments must be germane.

Direct spending. Defined in section 401(c)(2)(C) of the Budget Act, this is spending to which the government is committed whether or not appropriations are provided in advance.

This may include entitlement payments, contract authority, authority to incur indebtedness, and the authority to make payments (including loans and grants).

Reconciliation instructions to reduce direct spending are directed to the authorizing committee which has jurisdiction over the direct spending legislation.

Rescission. A reverse appropriations action. Rescissions require Acts of Congress. Reconciliation instructions which contemplate rescissions are directed to the appropriations committees.

Tradition dictates that appropriations actions originate in the House. Reconciliation instructions to the Senate Appropriations Committee have not, therefore, required Appropriations to submit its recommendations to the Budget Committee for inclusion in an omnibus reconciliation bill. They have been directed to report separately, and at a time which would allow the instructions to be met by amending the necessary legislation to a House passed bill.

Deferral. Deferrals delay obligation (and therefore outlay) of budget authority. The President defers funds and the deferral stands unless overturned by action of either House of Congress.

Reconciliation instructions do not contemplate deferrals, as these are not changes in law, i.e., the budget authority is not rescinded.

File Economic Programs

ty, and spending cutbacks on social programs until after the elections.

"But Reagan will press ahead on spending cuts while Democrats will try to extract further concessions from him, such as pushing for a six-month delay in the 1983 tax cut.

"The net of the situation in Congress is that Reagan could get a portion of what he wants before election with the right mix of appeals to the public and hard-knuckle politicking. A slide downward in interest rates, however temporary, could help the economy and Reagan's relations with Congress. But a worsening of unemployment and some spectacular bankruptcies could make the atmosphere even more sour and further diminish the chances of Reagan-sponsored legislation."

Concessions withdrawn. Reagan shows every indication of slugging it out with the Democrats. The administration insisted that any concessions its side offered in the collapsed talks were no longer available. "Everything is off the table now as far as we're concerned," Secretary Regan told reporters.

For various reasons, White House officials saw little chance for adoption of an oil-import fee or a surtax hitting higher-income taxpayers.

But the President apparently plans to try to woo as well as slug. Aides indicated that he will again try to win over the so-called Boll Weevils—conservative Democrats, mainly from the South, who voted for Reagan's 1981 spending cuts.

All agreed, however, that Reagan has a much more difficult row to hoe this year than last, when he beat the Democratic leadership in vote after vote on tax and spending issues. For one reason, opinion polls show a slide in Reagan's popularity, indicating to politicians that it is somewhat safer to oppose him.

In Congress, the weak economy has cooled off Reagan's support among the Boll Weevils. It also is causing Republicans to bolt. They fear that a slumping economy will turn voters against members of the White House party in November's elections.

Reagan did move to shore up his support among some conservatives who have been unhappy since he backed away from his campaign pledge to balance the federal budget in 1984. He endorsed passage of a balanced-budget amendment to the Constitution.

It was still too early to tell if Reagan's or O'Neill's stand will appeal most to voters. What seemed clear was that the issue won't be settled until the votes are counted in November. ☐

By JOHN R. GIBSON

Is Recession Over?

Despite the breakup of budget talks, Americans can look for some better economic news in the months ahead. But watch out for fresh snags, say seers.

The recession that began last summer appears to be just about over, but the rebound ahead is shaping up as the weakest since World War II.

Not even the collapse of budget bargaining between President Reagan and Congress alters prospects that a recovery, fragile though it may prove, will start soon. The worst that seems likely: Fears over massive federal deficits may keep interest rates so high that the impending upturn will be nipped in the bud later this year or in 1983.

At this point, latest evidence indicates that the nation in early May is on the brink of a mild business recovery.

Inflation is on the wane, with consumer prices actually falling in March—the first monthly drop in 17 years. Interest rates are inching down, while purchases by businesses and consumers hold firm.

Corporations have about finished reducing inventories, leaving room to place new orders. Housing starts are edging up. Stocks—advance indicators of economic performance—sprinted more than 70 points, as measured by the Dow Jones industrials, between March 8 and April 26, before tailing off.

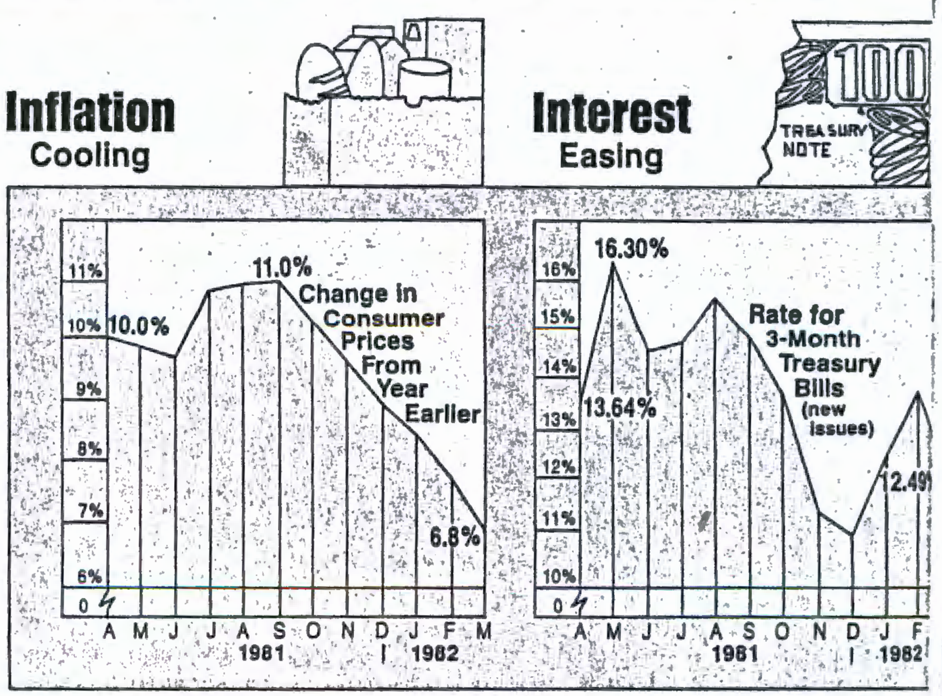
But the government's index of leading economic indicators signaled on April 30 that recovery is not here yet. It dropped for the 11th straight month.

Sums up Donald Straszheim, chief analyst for Wharton Econometrics in Philadelphia: "There are many straws in the wind that suggest the economy is preparing to turn up."

Good news. Among the straws are a sprinkling of corporate rehirings and new-investment activity. General Motors, for example, is recalling about 1,900 workers from indefinite layoff to the auto maker's Fairfax, Kans., plant. International Harvester announced on April 29 that 4,150 laid-off workers will be on the job again at four plants in the Midwest. GAF Corporation, the country's leading asphalt-roofing manufacturer, has reopened factories in Fontana, Calif., and Mount Vernon, Ind. More start-ups are planned. Hundreds of furloughed employes will return.

Signs of increased investment in new plant and equipment are cropping up, too. The Upjohn Company, maker of chemicals and health-care and agricul-

5 Signs of a Shifting Economy



tural products, will spend 34 million dollars to expand its main research complex in Kalamazoo, Mich. And Hoover Universal, Inc., is building a new plant in Murfreesboro, Tenn., to make truck seats. Frontier Airlines has ordered two Boeing 737s, a commitment of close to 30 million dollars.

Hydril Company will break ground later this year on the first of four oil-field-equipment plants. Total cost: 800 million dollars. "There will be an upturn, and, when it comes, we'll be ready," says Terry Merritt of the energy firm's Houston division.

As a result of all this, private economists and corporate executives contacted by *U.S.News & World Report* are sketching this scenario for the period immediately ahead—

After nine months of recession, business activity will mark time during the April-June quarter, then gather some steam at midsummer. Big reasons: A 10 percent cut in individual income taxes and a 7.4 percent cost-of-living hike for Social Security recipients, both set for July, will put 47 billion dollars a year into the hands of consumers.

Other factors. Prices, up only 6.8 percent over the past year, will continue to moderate—giving shoppers a break at the checkout counter. Wage gains and commodity prices also are easing, thus holding down business costs. Borrowers, both corporate and consumer, should see a slight ebbing of interest rates. Despite the latest prospects for huge federal deficits, the cost of money is expected to slip 2 or 3 percentage points from current levels before any uptick.

Unemployment, now 9 percent of the work force—or nearly 9.9 million people—is expected to rise for a few more months, then fall slightly by Christmas.

The tapering interest rates and pent-up demand may spark a small rally in housing and auto sales, two key segments of the economy. Already, home-building starts have risen for five straight months, to a March level that was almost 11 percent above last fall's. New-car sales, though, have eased off.

Buying patterns of consumers and firms are encouraging, as well. Businesses large and small notice a willingness among customers to spend more money. "Consumers appear to be starting to lead the economy out of recession," says Edward Telling, chairman of Sears, Roebuck & Company, the nation's largest retailer. Sales at Sears of longer-lasting household goods, such as appliances, are increasing, says Telling. Hess's, an Allentown, Pa., department store, reports that recent sales have been "fantastic."

Even though total economic activity sank in the first quarter, final sales of goods—those to businesses and governments as well as consumers—rose at a 1.8 percent annual rate. The marked slowdown in inflation along with gains in workers' disposable income accounted for the increase, say analysts.

Another key reason the economy is expected to show more pep: Widespread reduction of business inventories during the January-March quarter. Stock was liquidated at a 17.5-billion-dollar annual rate during the first quarter—the fastest since government began such records in 1929.

Such an extreme inventory swing, from accumulation to sell-off, usually is a harbinger that recession's end is near. This rapid emptying of shelves by manufacturers and retailers already has prompted a surge in orders for durable goods. March's total of new orders—81.3 billion dollars—was the highest since last September. Unofficial estimates show strength in April, as well.

All in all, says the latest monthly poll of 44 prominent analysts conducted by Eggert's Blue Chip Economic Indicators in Sedona, Ariz.: The economy will inch upward at a 1.5 percent annual rate in the second quarter, then register a gain of about 4.5 percent for the rest of 1982.

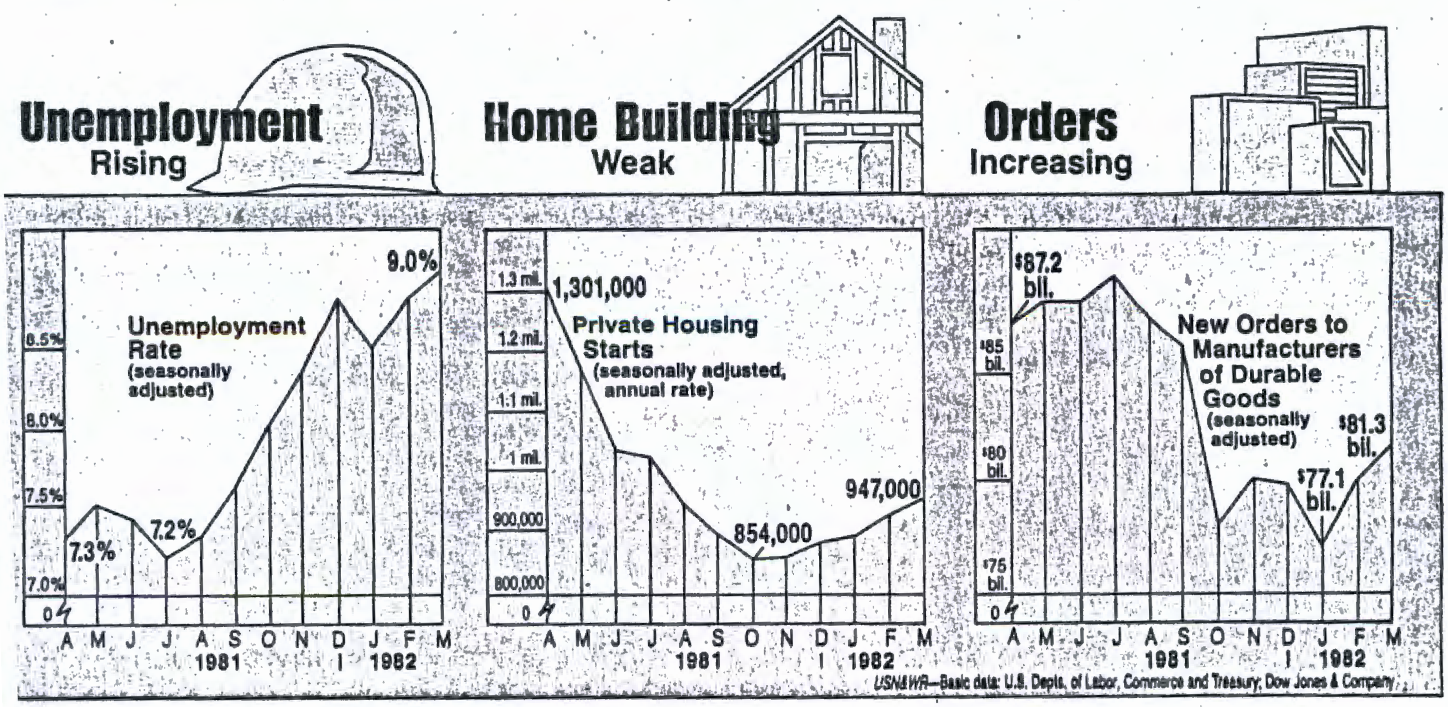
Waiting for proof. Despite hopeful trends, much is far from rosy. Many firms will remain leery until evidence of renewed customer demand and restored profits becomes concrete. Says Peter Cherry, head of Cherry Electrical Products Corporation, Waukegan, Ill.: "We want to be extremely cautious," despite a 20 to 25 percent jump in his firm's new orders over the past month.

This reticence means that heavy investment in new plant and equipment will be avoided. "It's going to take a lot more than a modest improvement to generate investment spending," says an executive at the Manville Corporation, a Denver-based building-materials firm.

All told, a period of nervous uncertainty for businesses and their workers seems likely for the rest of 1982. Still, some progress is expected—a welcome switch from the past year.

Says Norman Robertson, chief economist for Pittsburgh's Mellon Bank: "We're going to bump along the bottom for a while. But the recession is over, and the economy will be improving." □

By JAMES M. HILDRETH and the magazine's domestic bureaus



Interview With Murray L. Weidenbaum, Chairman, Council of Economic Advisers

Economic Recovery— How Soon, How Strong

Strength of the upturn depends on the final budget package, says the President's chief economist. If high federal deficits can be cut, interest rates should fall—and the economy's return to health will be speeded up.

Q Mr. Weidenbaum, when will the recession bottom out?

A The economy has hit bottom. The question now is when will the recovery begin. I don't yet see sufficient evidence of an upturn to call it. But there are encouraging signs—a major liquidation of inventories, a rise in new orders and a slight, but visible, increase in real consumer spending. I don't want to make too much of these indicators at this point, but if they continue, then the economy will work itself out of the recession.

Q What effect will the collapse of budget-compromise talks between the President and the Congress have on prospects for a recovery?

A A successful budget compromise would have been helpful, but it isn't critical. The forces for an upturn are under way, even without a budget compromise. But getting interest rates down would speed the recovery and make it stronger. The financial markets are very concerned about the prospect of large deficits. That's reflected in continuing high interest rates, which only recently have begun to ease. An important contribution to a further easing of interest rates would be a reduction in future deficits. Less competition from the government for investment funds would have a softening effect on interest rates.

Q How far will interest rates fall?

A Not as far as I'd like, for several reasons. The inflation premium of some 8 to 10 percentage points in interest rates is higher than I can explain by current or even prospective inflation. Even though inflation has dropped from the 12 or 13 percent rate of January, 1981, to an underlying rate about half of that, interest rates haven't made a similar adjustment.

One reason is financial deregulation, which I regard as a positive development. Most savers now are getting a competitive market rate of return instead of the controlled, below-market passbook rates of 5¼ or 5½ percent. That will bring about a desired increase in savings over time, but it does put upward pressure on interest rates.

Secondly, we live in a world capital market, and a number of other industrialized nations have larger deficits relative to their gross national products than we do. This demand on world capital markets to finance deficits puts upward pressure on interest rates worldwide.

Q Won't a recovery add to the upward pressure on interest rates?

A Not necessarily. If, because of the 10 percent tax cut coming in July and lower inflation, you get a rising share of personal and business income going into saving at a time when federal financing requirements are declining, the net result would be more savings available for private investment. That would ease the pressure on interest rates even if a recovery builds up steam.

Q Are high premiums—that is, a wide spread between the rate of inflation and prevailing interest rates—now a permanent part of the financial structure?

A I don't know. But I do know that bankers operate on the spread. That is, their lending rates are determined largely by a markup over what they pay for money, a cost that is set by the market.

Q But aren't the huge federal deficits that have been proposed adding to the inflation premiums being charged?

A I think the deficits do matter. That's why we in the administration are working so hard to reduce the expenditure side of the budget. The newest parlor game among economists is to debate why interest rates are so high. And some of the best-known private economists, none of whom are known for their modesty, admit that they don't know.

Our intuition tells us that the more the federal government competes with the private sector for the limited supply of saving, the higher interest rates will be. But how much higher, I don't know for sure.

Q Why have the President and his chief economic spokesmen appeared to talk with so many different tongues on the deficit issue?

A As circumstances change, the specific elements of any consistent policy need to adapt to the new circumstances. It's now quite clear that our deficits won't be declining the way we estimated in the February budget. That's what has changed. The outlook has changed. The weak first quarter pushed up spending and pulled down revenues. So, to respond to these changed circumstances, we need more budget cuts. We need a package of actions that will get those deficits in the future years below this year's 100 billion. But it is the same policy: A trend of declining deficits.

Q Returning to inflation, do you attribute the progress being made to the Federal Reserve Board's tight-money policy?

A Well, the downward slope in inflation started before the recession. But the shift from an easy-money policy by the Federal Reserve Board to a policy of gradual, restrained growth in the money supply probably is the single most important influence on the decline of inflation.

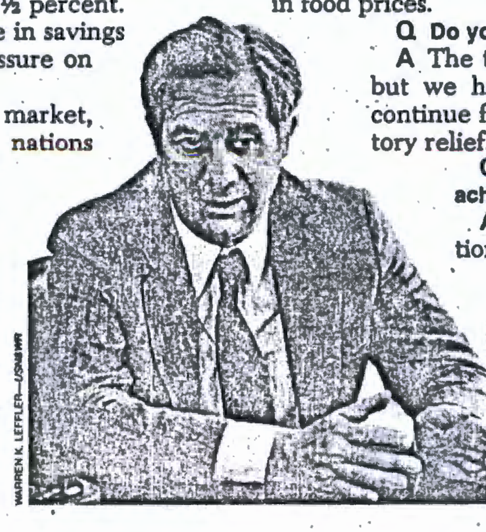
It's not the only reason, however. Deregulation of crude oil, which actually helped to lower gasoline prices, deserves some credit, and Mother Nature contributed to the decline in food prices.

Q Do you think that inflation has been conquered?

A The tide of the battle has shifted noticeably, but we haven't won the war yet. We need to continue fiscal and monetary restraint and regulatory relief.

Q How low must inflation be squeezed to achieve victory?

A Back in the Eisenhower years, inflation averaged between 1 and 2 percent. We can move a long way toward that


WARREN K. LEFFLER—USN&WR

Economist Weidenbaum, 55, served previous GOP administrations. At Washington University in St. Louis, he was director of the Center for the Study of American Business.

goal over the next few years, but I don't think we can reach it until later in the decade. However, my crystal ball gets very foggy beyond 1984.

Q How much unemployment would you accept to get down to that level?

A Clearly, today's 9 percent unemployment rate is far too high. The way to reduce unemployment is to achieve sustained economic growth. The trend toward fewer new entrants into the labor force will help. In the long run, we don't have to have higher unemployment to reduce inflation; we can have both low inflation and low unemployment.

Q How high will unemployment rise in the short run?

A It's close to the peak. There may be some very small further increases, but I don't believe unemployment will hit 10 percent.

Q Why hasn't the Reagan tax cut been more successful in stimulating investment, one of its major aims?

A Business investment is a lagging indicator. With consumer spending, which typically paces a recovery, just beginning to turn up, I think it will be a while before we see any major expansion in business investment. It will be the second stage of the recovery. When business investment does turn up, I expect a strong, sustained upturn. That will be the true test of the 1981 business-tax cuts.

Q Are you saying that the tax cut is less important than the economy's performance in stimulating investment?

A No. I'm saying the business-tax cut is a long-term program, not a quick fix. To achieve a sustained recovery, in contrast to the stop-and-go economy of the past, we need adequate capital investment. I'm just cautioning against expecting too much investment too soon.

Q How would you prefer to reduce deficits?

A Expenditure reduction. I'm a hawk on spending cuts.

Q Including the defense budget, which the President has put off limits?

A I wouldn't limit cuts to the civilian budget. We need a very major expansion of our military capabilities in this dangerous world, but it's a matter of judgment as to how fast you proceed. I, personally, wouldn't immunize any department, including the Department of Defense, from the toughest budget scrutiny. But, ultimately, it's the President who must decide national-security priorities.

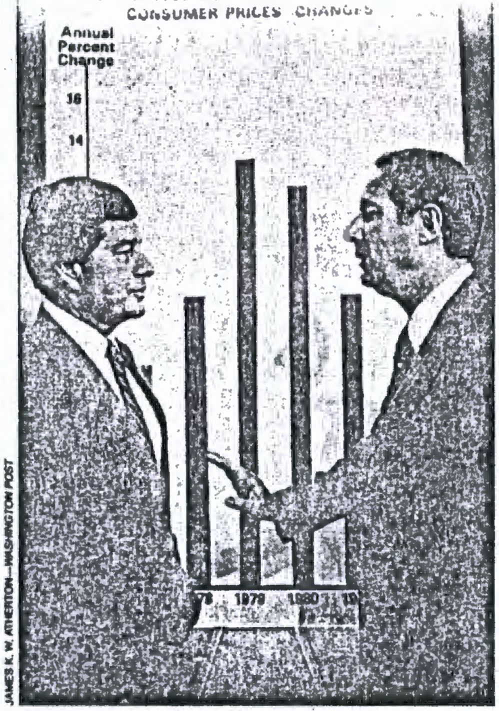
Q Originally, the President also ruled out any cuts in Social Security. Do you agree with that?

A I think the President would like a bipartisan agreement on how to address the Social Security question. He said he was willing to walk the "extra mile" to get a comprehensive deficit-reduction package from Congress, a portion of which might have included an adjustment in Social Security cost-of-living increases. In other words, he took that walk up to Capitol Hill, but it takes two to strike a bargain.

Q If you were teaching a class in economics, how would you describe the Reagan administration's economic policy?

A It's a blend of the major schools of modern conservative economics. The tax cut is a "supply side"-oriented program to provide new incentives for work, savings and investment. The steady reduction in the growth of the money supply is clearly monetarist. The spending cuts and regulatory relief are traditional conservative economics.

Q Don't you worry that clashing melodies coming from the administration are adding to anxieties of the financial markets?



JAMES K. W. ATHERTON—WASHINGTON POST

Weidenbaum discusses economic indicators with Senator Mack Mattingly (R-Ga.).

A I thought we were all singing from the same hymn book.

Q It doesn't sound that way—

A Well, some of us can carry a tune better than others. It depends on your musical training.

Q But are the supply-side advocates singing with muted voices now?

A We are carrying out a historic supply-side tax policy. Our determination to put into effect a 10 percent tax cut this July followed by another 10 percent cut next July should be heartening to the truest, bluest supply-sider. Let's face it, conventional Republican economics would have said: Cut spending first and hold off on the tax cuts until you balance the budget. Instead, we're cutting both taxes and spending, which is supply-side economics, as I understand it.

Q The Republicans have been in office for some 16 months now, and Treasury Secretary Regan says the economy is dead in the water and the country is in a mess. What's wrong?

A The economy's been in a mess for some time. We said that when we took office. If you go back to ancient history, like Feb. 18, 1981, when the President unveiled his program for economic recovery, you will see that we emphasized that it was not a quick fix but a plan to produce long-term results. We said the first year would be a period of very slow growth.

Q Now we have a second year of very slow growth—

A The economy is in a holding pattern. It's marking time.

Q Because Congress and the President failed to reach an accord on the budget, many experts now believe the anticipated recovery will be short-lived. Do you agree?

A No, I don't. I still think there is a basis for looking forward to an extended recovery, even though it might not be as brisk as it would have been with an immediate budget compromise. Interest rates should still trend down, even though the pace of that decline won't be as rapid. As for the possibility that there still may be a budget compromise later this year to reduce future deficits, hope springs eternal.

Q If there's no tangible evidence of an economic turnaround soon, do you fear the voters will turn against the Republican Party next November?

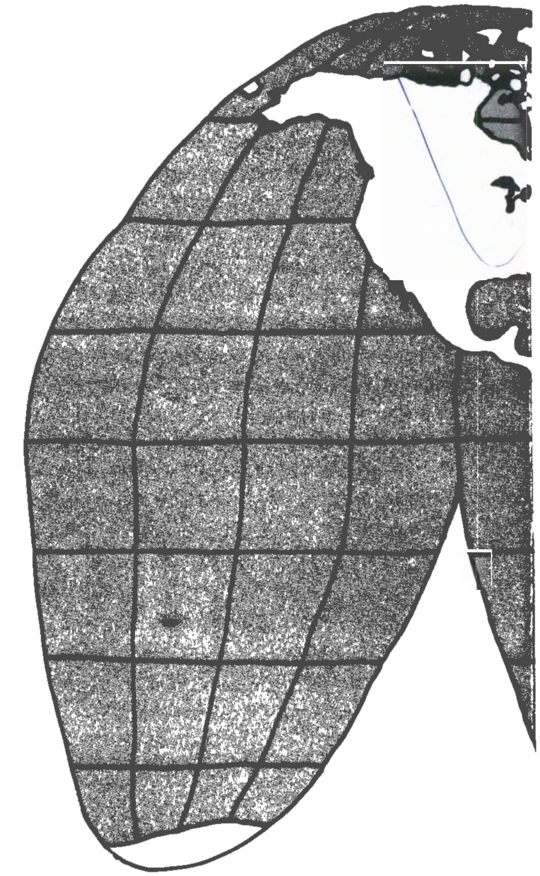
A I'm not good at political forecasting. Clearly, the recession has brought about a temporary dip in the popularity of the President who happens to be in office. But I do think the American public has a longer memory than many experts give it credit for.

When we took office in January, 1981, every opinion poll I know of showed inflation as the No. 1 economic concern of the voters. We have delivered on that one. We have fundamentally improved the inflation situation. This means that the living standards of all working families will improve as the years go by. I think the voters know that and will take an upbeat view of the administration at election time.

Q How does President Reagan compare with other Republican Presidents you've worked for?

A He has a keener interest in, and a deeper understanding of, economics. On my first day in office, he reminded me that he was an economics major in college. He told me that one of the principal goals of his Presidency would be to raise the level of economic education in this country. □

SUPPLY-SIDE SUCCESS STORIES



Far from being untried, supply-side economics has achieved considerable success around the world.

BY BRUCE BARTLETT

SURELY THE MOST AMAZING story in the economic history of the world since the Second World War is the remarkable resurgence of West Germany and Japan as world economic powers, following the almost total destruction of their economies by war. In large measure, their success can be attributed to tax policies which encouraged growth. Moreover, the poverty of Third World nations and their restrictive tax policies stand in stark contrast to the successes of Germany and Japan. Although the United States has given away billions of dollars in foreign aid since World War II, it has failed to alleviate world poverty. The only way that that can be done is by encouraging poor nations to reduce high tax rates and to adopt policies which encourage economic growth.

HOW GERMANY DID IT

When the war ended and Germany became occupied by Britain, France, the Soviet Union, and the United States, the nation was split between East and West—a division that continues to this day. The eastern half, under Soviet occupation, was turned into a Communist state, with total State control of the economy. West Germany, by contrast, developed a free economy under the leadership of Konrad Adenauer and Ludwig Erhard. However, it was an uphill struggle. When the Western Allies occupied Germany, they disagreed about what actions should be taken with respect to the economy. So they decided simply to continue the status quo, maintaining all the existing taxes and economic controls. Erhard, who was West Germany's economic minister, apparently hit upon a ploy to unleash the German economy. He surmised that although he was prohibited from making any changes in the existing controls without approval of the occupying powers, there was no law that said he could not *abolish* controls. According to Erhard:

> *It was strictly laid down by the British and American control authorities that permission had to be obtained before any definite price changes could be made. The Allies never seemed to have thought it possible that someone could have the idea, not to alter price controls, but simply to remove them.*

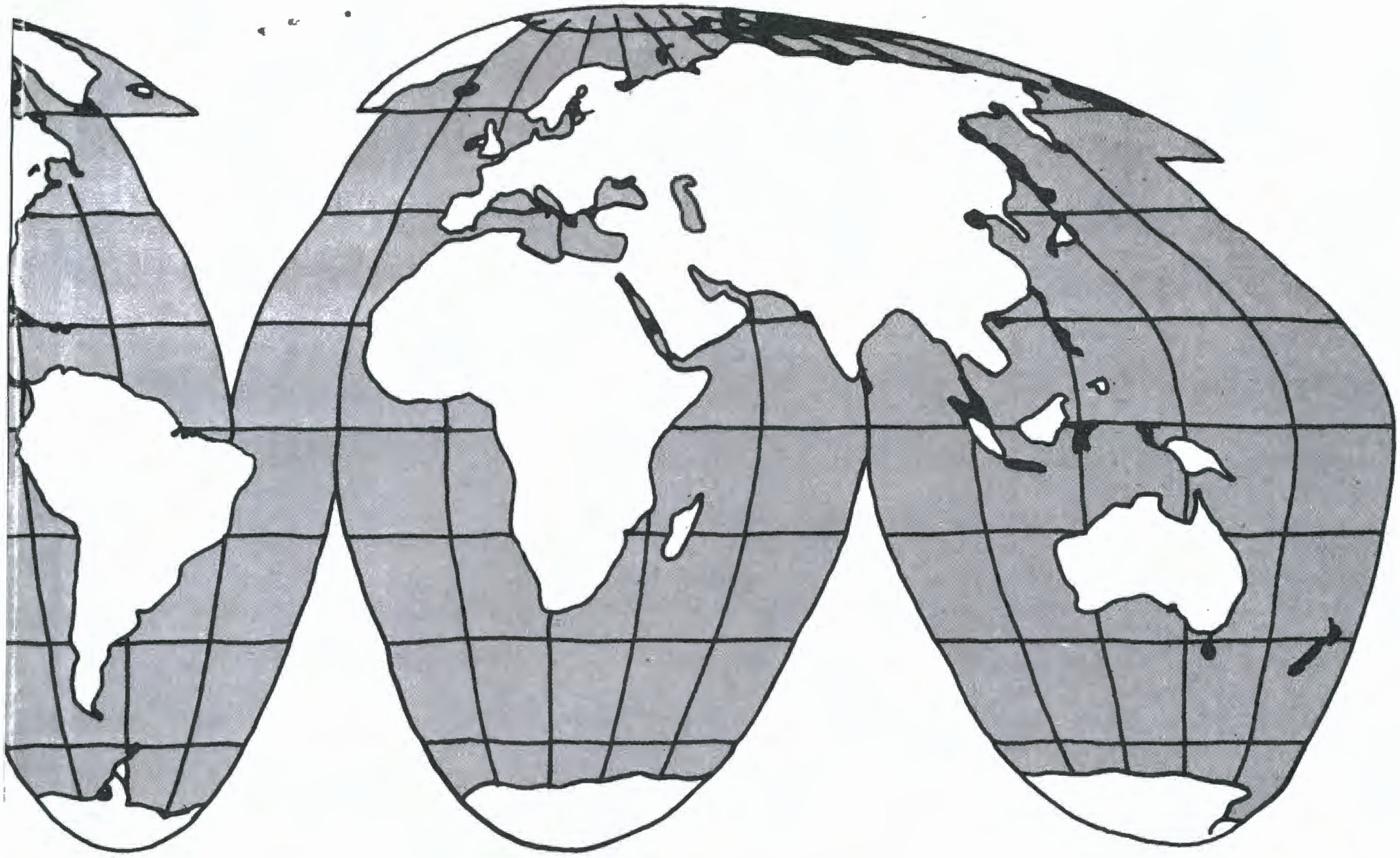
This Erhard did. Simultaneously, he instituted currency reform, which halted the rampaging inflation, and moved to cut taxes and restore freedom throughout the economy.

Until the middle of 1948, a 50 percent marginal tax rate on personal income became applicable as soon as an individual's income passed the 2,400-Reichsmark level (about $600), and a 95 percent rate was applicable to income exceeding 60,000 Reichsmarks (about $15,000). It was noted that without a thriving black market, outside the reach of tax authorities, combined taxes on income and property might have equaled or exceeded total income. Indeed, it was estimated that half of total income taxes went unpaid.

Beginning in 1948, however, West Germany began steadily reducing tax rates and instituting special tax incentives for saving and investment. As the table on p. 50 shows, by 1958 the highest marginal tax had been reduced from 95 percent to 53 percent, while the personal exemption and the threshhold income at which the 50 percent marginal rate was reached had been steadily increased.

The result? West Germany now has the fourth-largest gross national product of any nation in the world, amounting to $640 billion in 1978, and a per capita GNP significantly larger than in the United States.

It is generally believed that the Marshall Plan was a significant factor in Germany's rise. In fact, however, the Ger-



man recovery began before Marshall Plan aid arrived. Moreover, Germany received significantly less aid than did France or the United Kingdom. Consequently, one must conclude that, while the Marshall Plan was helpful, it was not necessary for Germany's recovery.

Lastly, it should be noted that, although the German revival took place during the heyday of Keynesian economics, Keynesian principles were explicitly repudiated by Erhard and the other German policymakers. As economist Egon Sohman has observed, "West Germany's impressive recovery took place under policies that were in many respects the direct antithesis of post-Keynesian prescriptions for rapid economic growth."

JAPAN'S SUCCESS

The situation in Japan was different, of course. Not only did Japan have a different history and culture, but it was under the sole occupation of the United States, with Gen. Douglas MacArthur in almost total control of the country following the end of war.

During the initial occupation period, 1946-49, the principal problem was halting the spiraling inflation. Unfortunately, the initial tax reforms imposed by the occupation authorities were totally unsuited to an inflationary environment. Among these initial reforms were (1) higher and more-progressive individual income tax rates and lower exemptions, (2) higher corporate and excess-profits taxes which did not allow taxpayers to adjust depreciation allowances for inflation, (3) a heavy capital levy on wealth, and (4) an increase in the number of sales and excise taxes, including a turnover, or value-added, tax.

The poverty of Third World nations stands in stark contrast to the successes of Germany and Japan.

These disastrous tax changes soon led to a breakdown of the tax-payment system. Tax evasion was widespread; tax collectors became as hated as the prewar secret police; businesses were falling apart because they could not replace capital; and revenue was seriously lagging behind expectations. It was these factors which led General MacArthur to invite a distinguished group of American tax specialists to come to Japan and rewrite its tax system. The group became known as the Shoup Mission, after its leader, Prof. Carl Shoup of Columbia University.

The first thing recommended by the Shoup Mission was a drastic reduction in tax rates and an increase in exemptions. The top bracket was brought down from 85 percent to 55 percent, the personal exemption raised from 15,000 to 24,000 yen, and a tax credit for dependents of 12,000 yen per dependent instituted. With regard to business, the main contribution of the Shoup Mission was in revising depreciation schedules to account for inflation. In addition, the excess-profits tax was eliminated and the corporate tax rate reduced to 35 percent. Lastly, a large number of technical and administrative reforms was proposed and carried out. At its conclusion, the Shoup Mission declared that Japan now had one of the best tax systems in the world.

These reforms gave Japan's economy a big boost. Since then, the Japanese government has carried forward the growth-oriented tax policies instituted by Shoup. Because of the enormous Japanese economic growth of the postwar era—which has given Japan the third-largest GNP in the world: $969 billion in 1978—the government has received an enormous influx of tax revenue

Individual Income Tax Rates in West Germany, 1946-66

(Reichsmarks or Deutschemarks)

Period	Personal Exemption	Income at which Marginal Rate Reaches 50%	Highest Marginal Tax Rate	Income at which Reached
1946–mid-1948	600	2,401	95	60,000
mid-1948–1949	750	9,001	95	250,000
1950-52	750	20,001	95	250,000
1953	750	36,001	82.25	220,000
1954	800	45,001	80	220,000
1955-57	900	125,001	63.45	605,001
1958-66	1,710	78,420	53	110,040

Source: Karl Hauser, "West Germany," in *Foreign Tax Policies and Economic Growth* (New York: Columbia University Press, 1966), p. 147.

Estimated Annual Tax Changes in Japan, 1950-74

(Yen in Billions)

	Individual Income Tax				Corporate		
Fiscal Year	Exemptions	Rates	Special Tax Changes	Total	Rates	Other	Total
1950-53	−272	−86	−28	−386	+31	−56	−25
1954	−29	0	−2	−31	0	−3	−3
1955	−23	−13	−18	−53	−14	+2	−12
1956	−23	0	0	−23	0	+14	+14
1957	−40	−85	+15	−110	−2	+24	+22
1958	0	0	−6	−6	−20	−2	−22
1959	−28	−12	+17	−23	0	−4	−4
1960	0	0	0	0	0	0	0
1961	−38	−23	+5	−56	0	−40	−40
1962	−25	−23	−2	−50	0	−1	−1
1963	−32	0	−35	−67	0	+13	+13
1964	−66	0	−8	−75	−5	−54	−59
1965	−92	0	+26	−65	−28	−28	−57
1966	−101	−53	−4	−158	−50	−49	−99
1967	−142	+11	+38	−93	0	−30	−30
1968	−135	−11	0	−125	0	0	0
1969	−142	−41	0	−183	0	+2	+2
1970	−173	−131	+15	−289	+97	−22	+75
1971	−286	−107	−22	−415	0	+12	+12
1972	0	0	−32	−32	0	+31	+31
1973	−335	0	−40	−375	0	+27	+27
1974	−1,467	−260	−56	−1,783	+424	−72	+352

Note: Totals may not add due to rounding.
Source: Joseph A. Pechman and Keimei Kaizuka, "Taxation," in Hugh Patrick and Henry Rosovsky, eds., *Asia's New Giant: How the Japanese Economy Works* (Washington: Brookings Institution, 1976), p. 325.

However, the Japanese government has not used this revenue to boost the size of the public sector but has instead returned this "fiscal dividend" to the people in the form of tax reduction, which in turn has stimulated further economic growth. As the table above shows, between 1954 and 1974, individual income tax exemptions were increased every year but three, individual income tax rates were reduced eleven times, and corporate tax rates were cut six times.

One last point: Japan's remarkable postwar economic performance is all the more amazing when one considers its small size (143,000 square miles—about the size of Montana), its enormous population (114 million in 1977—793 people per square mile), and its almost total lack of natural resources, particularly energy. The only thing which detracts from Japan's record is the even more amazing performance of its Asian neighbor Hong Kong.

HONG KONG HOW-TO

In many respects, Hong Kong is the greatest example of the success of the free market in action the world has ever seen. The British crown colony occupies a mere 404 square miles, with most of its 4.5 million population cramped into 12 percent of that area. Population density exceeds 400,000 people per square mile in many areas. And the colony must import 85 percent of its food, most raw materials, and all capital equipment.

Nevertheless, between 1948 and 1977 the per capita income of Hong Kong increased from $180 to $2,600 per year. Between 1960 and 1976 its real per capita GNP increased by an amazing 6.4 percent per year (compared to just 3.3 percent per year for West Germany and 2.4 percent per year in the United States).

One important reason for Hong Kong's success is its extremely low taxes. The maximum tax rate on profits is 17 percent, and the maximum tax on individual incomes is 15 percent. There is no tax withholding in Hong Kong, and the estate tax has a maximum rate of only 18 percent on estates of over $3 million. Writes economist Alvin Rabushka:

> *Hong Kong has, to my knowledge, the lowest standard rate of tax on earnings and profits of any industrial state. . . . The official line is Gladstone reincarnated: a narrow tax base and low standard rates of direct taxation facilitate rapid economic growth which generates high and ever-increasing tax yields. These revenues, in turn, finance an extremely ambitious program of public expenditure on housing, education, health, and welfare services, and on other forms of social and community services, with virtually no need to resort to loan finance.*

In short, Hong Kong is an almost perfect example of the Laffer Curve in action—low tax rates generate high rates of real economic growth, leading to increased revenues which can be used for social welfare while maintaining low tax rates. Conversely, one finds that welfare states which rely on high tax rates are invariably experiencing serious economic difficulties, imperiling existing social welfare programs. A perfect example is Sweden, the welfare state par excellence.

SWEDISH SECOND THOUGHTS

For many years, American liberals considered Sweden something of an ideal State. It seemed to be living proof that individual liberty, a high rate of economic growth, and a wide range of social welfare benefits could coexist. However, in the mid-1970s it all began to fall apart. The enormous tax burden, which consumes more than 60 percent of Sweden's gross domestic product; inflation; and collapse of the social contract which kept Sweden's labor unions in line for 40 years all worked together to bring its economic growth to a standstill. In 1977 Sweden's GNP actually declined 2.5 percent.

The Swedish Employers' Confederation recently estimated that a family of four with an earned income of $4,600 per year in 1978 would net $14,117 when all government welfare benefits were added. On the other hand, a family of four with an earned income of $23,000 would also net $14,117 after taxes were subtracted. Thus, increasing one's income from $4,600 to $23,000 would have absolutely no effect on the family's net income—an implied marginal tax rate of 100 percent.

Such incredibly high taxes cannot help but seriously diminish the incentive to work. As a result, Sweden's Nobel laureate in economics, Gunnar Myrdal, an architect of the Swedish welfare state, recently suggested a complete overhaul of the tax system; a drastic reduction in personal income tax rates, with reduced revenues to be made up by raising sales taxes. Myrdal writes:

> *My main conclusion is that income taxes are bad taxes from several points of view. . . . For the majority of people . . . a high and progressively increasing marginal tax rate must decrease the willingness to work more than necessary. . . . Through the lowering of the income tax, the irrational direction of investment from production to durable consumption goods would not be so severe. . . . The fact that the consumption tax is a tax on living standard instead of income, and therefore puts a premium on saving and capital accumulation, should be liked by most everyone, especially in these times.*

Of course, Sweden would have killed its economy long ago had it not adopted some tax policies favorable to growth. It draws very high taxes from individuals but leaves its industrial concerns relatively alone and motivates them highly. Sweden gives businesses very generous depreciation allowances; it taxes inventory profits lightly; it eliminated the double taxation of corporate dividends; and it generally taxes corporations less than in many other countries. In 1972, for example, Sweden collected 3.9 percent of its tax revenue from business income taxes, compared to 7.1 percent in Great Britain and 11.2 percent in the United States. However, it is not enough just to be lenient on corporate income. At some point, there must also be some compensation for individual incentive, because individuals, not corporations, are ultimately the driving force in any economy.

Unfortunately, many Third World countries attempt to duplicate the tax systems of countries like Sweden without realizing that Sweden's system only worked for as long as it did because it already had a well-developed capital structure and a highly skilled and disciplined work force and was able to capitalize on some fortuitous circumstances, such as remaining neutral in World War II while making a fortune on sales of raw materials to the Nazis. Thus these Third World countries impose on subsistence economies tax systems designed for modern industrial states and then wonder why no growth occurs and no revenue is raised. When they turn to "development experts" for advice, they are invariably told that high, progressive income taxes are just the thing. As one such expert, Barbara Ward, recently wrote, "No nation has even half-way peacefully entered the modern world without a progressive income tax."

Sweden would have killed its economy long ago had it not adopted some tax policies favorable to growth.

Economic consultant Jude Wanniski has pointed out that highly progressive tax structures are doubly harmful because worldwide inflation ends up making already high marginal tax rates even higher. He therefore argues that most of the Third World is high on the upper end of the Laffer Curve, with a few exceptions. He points to the Ivory Coast, where the highest marginal tax rate is only 37.5 percent, and Venezuela, where the highest rate is 25 percent, as success stories. However, the two greatest successes in recent years among underdeveloped countries experimenting with the free market must be Chile and Puerto Rico.

THE CHILEAN CASE

Since the overthrow of Pres. Salvador Allende by a military junta led by Gen. Augusto Pinochet, Chile has been treated as an outcast among nations. Unfortunately, this has led people to ignore or dismiss the remarkable economic experiment taking place in Chile.

When the junta took over in 1973, inflation was *1,000 percent* a year, and the country was virtually bankrupt. In March 1975 President Pinochet was approached by his government economists. They told him that the collapse in world copper prices would cost Chile $1 billion a year in lost export earnings, that the increase in world oil prices would cost Chile some $300 million in higher imports, that this would reduce Chile's GNP by 13 percent, and that if he attempted to spend his way out of trouble, inflation would exceed that of the Allende years. With Chile's considerable foreign debt, the country could not expect outside help.

Pinochet decided to adopt an austere economic policy and appointed a group of University of Chicago-trained economists—dubbed the "Chicago Boys"—to run the show. They put the brakes on the money supply to stop inflation, took controls off interest rates to encourage saving, ended capital controls, cut taxes and indexed them to inflation, and eliminated all existing tariffs—which averaged 100 percent—and substituted a flat 10 percent duty on imports.

There was considerable doubt that this program would work. Many of Chile's businesses needed high tariffs to survive. When forced to compete, a lot of them went under. But those that survived and learned to compete prospered. Chile's largest appliance manufacturer tells this story: "In 1974 we had 5,000 workers and a productivity of only $9,000 a year per worker. Now we have 1,860 workers and a productivity of $43,000 per worker, and we are finally showing a profit."

Some $5 billion in foreign investment

flowed into Chile between 1975 and 1980. The public sector's share of gross domestic product fell from 43 percent in 1973 to about 30 percent in 1979. Four-fifths of the companies nationalized by Allende have been sold back to the private sector, and those nationalized industries that are left are more tightly managed and beginning to show profits. Inflation is down from 1,000 percent to about 30 percent per year. A recent report by the US Embassy in Chile concludes:

> *In its reliance on market economics, Chile appears in the vanguard of a world-wide neo-conservative response to the menace of growing inflation. . . . Inflation remains Chile's major economic problem, however the three interrelated problems of unemployment, high interest rates and low fixed capital investment are on the way to being solved. . . . Most U.S. private-sector observers are inclined to believe that the current military regime will be followed within 10 years by a stable, middle-of-the-road government reasonably favorable to free enterprise and foreign investment. It has been noted that the constituency for the current liberal economic program is growing.*

Of course, Chile continues to have a repressive policy toward political dissent, and many freedoms that are taken for granted in the United States and Western Europe are denied. However, the criticism of the Chilean regime generally misses a critical point: it is possible to have a free-market economy without political freedom, but the converse is not true; you cannot have political freedom without a free economy. Thus, while Chile may be a long way from being a liberal state, it is at least half-way closer than the vast majority of other nations, which have neither political nor economic freedom.

PUERTO RICAN PROGRESS

Puerto Rico is a "purer" example of the Laffer Curve in action because its success stemmed directly from Arthur Laffer's influence. During the 1970s Puerto Rico's economy stagnated, its growth in real GNP going from a 13 percent increase in 1969-70 to a 2.5 percent contraction in 1975-76. Unemployment rose and private saving was nonexistent. In 1974 Gov. Hernandez Colon invited liberal Keynesian economist James Tobin to come to Puerto Rico and offer economic advice. Tobin advised an expansion of government spending financed by higher taxes. Colon then proposed a 5 percent surtax on Puerto Rican incomes, which the islanders dubbed *La Vampirita*, or "Little Vampire."

In 1976 Romero Barcelo of the New Progressive Party was elected governor, ending almost 40 years of rule by the Popular Democratic Party. Romero's principal campaign promise was to eliminate *La Vampirita*, which he did in January 1977. He also promised further tax cuts and growth-oriented policies. As Treasury Secretary Cesar Perez commented, "We cannot talk about raising taxes; we must raise revenues by restoring prosperity."

In 1978 Laffer was invited to Puerto Rico to study the island's fiscal system and offer recommendations. Laffer advised income tax rate reductions to get the top marginal rate down to 50 percent, a reduction in the corporate tax rate from 45 to 25 percent, a reduction in government expenditures as a percentage of GNP, and other economic reforms.

"The things Laffer told us would happen are happening," admits Puerto Rico's Governor Romero.

In 1978 the 5 percent World War II victory tax was eliminated. In 1979 there was a flat 5 percent reduction in income taxes. By early 1980 these cumulative tax reductions had so expanded Puerto Rico's economy that tax collections in 1980 were running 13.5 percent ahead of 1979. "It is extremely difficult to say it is all due to the tax cuts," Governor Romero says, "but the things Laffer told us would happen are happening. In fact, he guaranteed it would happen."

Based on the success so far of a 15 percent cumulative tax reduction, Puerto Rico enacted another 15 percent income tax reduction, to take place between 1980 and 1982. In defense of the new program, Governor Romero said, "I'm sold that the [Laffer] theory is correct. He wanted me to take a much bigger step initially but I couldn't. I felt I was charged with the responsibility of balancing the budget and I couldn't gamble on a 15% cut in one chunk. I said if it is going to show results with 15% it will show results with 5%."

Interestingly, there are more than 100,000 more taxpayers on the rolls in 1980 than in 1979, the result of lower tax rates which discouraged taxpayers from cheating. This evidence must, therefore, strongly support the Laffer view that tax rates can reduce revenues by discouraging work and encouraging tax cheating.

THE STORIES' MORAL

These examples support the view that the best thing the industrialized countries can do to help the Third World is to encourage them to adopt free-market policies, rather than to promote more foreign aid programs. As David McCord Wright puts it:

> *We must remember, first, that the whole social surplus of Europe, Russia, and America could not make more than the tiniest dent on the poverty of the world. To a large extent, therefore, our aim must be not to give people goods, but to help them toward a situation in which they can improve their own productivity. . . . The main issue is not building a few projects, but transmitting to the underdeveloped nations something of Western dynamism and democracy. The astounding feature of the last two centuries has been the sustained rise and spread of the ideas of economic growth and the ideas of personal freedom and democratic government. . . . Here is a growth impulse that has not lasted merely for the lifetime of one or two great rulers, not been confined to a small clique, and is still going. Can we assert categorically that there are many roads to such a result?*

Some have even argued that foreign aid is detrimental to growth. They assert that because foreign aid is invariably a government-to-government transfer, its main effect is to strengthen the public sector in underdeveloped countries—the opposite of what would actually do some good. "Foreign economic aid," writes Milton Friedman, "far from contributing to rapid economic development along democratic lines, is likely to retard improvement in the well-being of the masses, to strengthen the government sector at the expense of the private sector, and to undermine democracy and freedom."

The common thread running through

all the economic success stories of the postwar era is a heavy reliance on the private sector and a government which cut taxes and allowed free markets to operate. Socialist and Keynesian policies have not proven effective. Thus Gottfried Haberler writes:

> *In all developed industrial countries policies of economic recovery, stabilization, and growth have been much more successful after the second World War than after the first. But it is difficult to attribute this to the spread of Keynesian thinking. It so happens that none of the economists and economic statesmen who were largely responsible for all the assorted postwar economic miracles can be called a Keynesian: not Camille Gut in Belgium, nor Luigi Einaudi in Italy, nor Ludwig Erhard in Germany, nor Reinhard Kamitz in Austria, nor Jacques Rueff in France. The greatest economic miracle of all, the Japanese, seems to have been performed by conservative Japanese governments and statesmen with the help of some ultra-conservative American advisors, while the numerous Keynesians and Marxo-Keynesians had to look on in impotent opposition.*

There seems to be no escaping the conclusion that the best path to economic growth lies in low taxes and free markets. The successes of Japan, West Germany, Hong Kong, Chile, and Puerto Rico are living testaments to this fact. r

Bruce Bartlett is deputy director of the Joint Economic Committee of Congress and the author of Cover-Up: The Politics of Pearl Harbor. *This article is excerpted by permission of the publisher from his just-published book* "Reaganomics": Supply Side Economics in Action *(Arlington House).*

File
Econ Package

THE WHITE HOUSE

WASHINGTON

October 19, 1981

MEMORANDUM FOR SENIOR STAFF AND CABINET MEMBERS

FM: David Gergen

RE: Attached Briefing Book on Additional Budget Savings and Modernization of U.S. Strategic Forces

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The White House Public Affairs staff under Mike Baroody has prepared the attached briefing book on the President's Fall proposals. The document should be of use to you as a quick reference guide and summary of the President's October budget revisions and strategic modernization plan.

These materials also form the basis for a shorter executive briefing book, to be published next week. It will be available for distribution to the press and public at large.

PRESIDENT REAGAN'S FALL PROPOSALS

Additional Budget Savings

Modernization of U.S. Strategic Forces

October 1981

Prepared By The White House Public Affairs Office

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OVERVIEW

ROUND TWO OF THE BUDGET CUTS

* Purpose of second round same as first

  — restoration of economic growth and the creation of jobs

* Goals the same

  — 13 million new jobs by 1986

  — balanced budget in 1984

  — inflation down to 5 percent in three years

  — increased savings and investment

  — end of interference in average American's lives

* Progress has been made since program unveiled last winter

  — growth of spending has almost been cut in half, from over 14 percent a year to 7.5 percent

  — inflation has declined 2 1/2 points since January

  — the largest tax cut in history has been put in place

  — regulations have been reduced, with publication of new regulations down a third and the size of the Federal Register cut in half.

* More to be done — both short and long term

  — Federal budget has been balanced only once in the last 20 years

  — Getting spending under control can't be done in just six months; it requires long-term commitment

  — Substantial budget overruns threaten in the short term. Spending estimates ballooned from $695.5 last March to about $722 billion in September.

* <u>President moved decisively to reduce overruns</u>

  — <u>Reasons for overruns:</u>

    - Congress' failure to enact all of first round savings

    - High interest rates

    - Automatic growth of entitlements and subsidies

  — Second round always planned. Overruns reason for needing it <u>now.</u>

  — Without second round, deficit for just fiscal '82 would have grown to about $60 billion and the government would have been in the credit markets, borrowing $80 billion for the third year in a row.

  — Pressure would continue in the markets to keep interest rates high.

  — <u>High interest rates are the largest single remaining obstacle to the economic recovery.</u>

* <u>Second round tougher to get than first</u> — <u>still "do-able"</u>

  — Easy cuts have been made.

  — President requesting:

    - entitlement reform
    - 12 percent cuts in discretionary spending
    - 75,000 fewer federal employees
    - reduced federal borrowing and lending
    - prudent defense spending cuts
    - abolition of Departments of Energy and Education
    - enhancement of revenues through users' fees and tax code revision

  — Savings would reduce federal spending from 23% of GNP in 1981 down to 19% of GNP in '84.

    - deficits will be held to:

        - $43.1 billion in fiscal '82
        - $22.9 billion in fiscal '83
        - $ 0.0 in fiscal '84

* <u>President commited to firm, steady economic course.</u>

  — Government has overspent its own targets in 8 of the last 10 years — by almost $50 billion in each of the last 2.

  — If enacted by Congress, the second round of cuts can prevent overrun, restore confidence in markets, reduce interest rates, help bring on growth.

* <u>What is at stake</u>

  — Failure to enact the second round and keep control of federal spending will mean a return to business as usual.

  — Preventing spending overrun will signal to Americans on Wall Street and Main Street, as well as the world financial community, that this government is serious about breaking the cycle of past economic policy and intends to stick to the course President Reagan set last winter and Congress adopted in the summer.

<u>BUDGET CUTS — ROUND TWO</u>

(Talking Points)

On September 24th, President Reagan outlined to the nation his proposal for additional budget savings. In his televised speech, the President repeated his commitment to:

* maintaining a firm and steady course on economic policy,

* reducing the deficit to help bring down interest rates — the biggest remaining barrier to economic growth, and

* achieving a balanced budget by 1984.

When President Reagan took office, he inherited the worst economic mess since the Great Depression. Unemployment, high interest rates, low productivity and inflation made economic recovery the President's first priority. It remains so.

— The purpose of the economic recovery program is the stimulation of economic growth and job creation. With adoption of the program, some <u>13 million new jobs</u> will be created by 1986.

— When the first cuts were announced, the President said additional savings would have to follow. This second round totals about <u>$80 billion over the next three years.</u>

— As the program takes effect, (it started October 1st) President Reagan has proposed action to <u>prevent any spending overruns</u> of the sort which have plagued other administrations.

— Such an overrun threatens. Because of high interest rates and general economic sluggishness, the March spending projection of $695 billion had grown to $705 billion by July and to $722 billion by the latest estimates. Additional budget savings had to be found to <u>keep the deficit</u> under control and in the originally planned <u>$42-43 billion range.</u>

— <u>Controlling the deficit</u> now is the only course that can keep the government moving in the direction of a balanced budget by 1984.

— The President is committed to keeping to this course. The additional savings announced on the 24th demonstrate the strength of that conviction.

-- By moving decisively to prevent budget and deficit overruns, and thereby minimizing government borrowing, the President is helping to reduce the upward pressures on interest rates, which remain the biggest barrier to economic recovery, growth and job creation.

-- Critics who say the President's program isn't working fail to acknowledge not only that it has just begun (on October 1st) but also that some improvement has already been noted: inflation has eased, particularly with respect to fuel prices and interest rates have come down some in recent days.

Defense Cuts

-- Except for Social Security, no Department or program has been exempt from the cuts. In addition to the $2 billion pared from the Defense Department budget increase for next year, $3.5 billion in Pentagon budget savings had already been identified and included in the orginal budget submission.

Social Security

-- On Social Security, the President proposed his original plan in response to Congressional requests for the Administration's proposals. It was to have been a basis for bipartisan discussion leading to a consensus plan to save the system.

-- The Majority leadership in the House of Representatives chose instead to make the social security issue a partisan one so the President withdrew his plan, proposing interim measures to insure the system's solvency and restore the minimum benefits for those who depend on them. (The Senate voted to restore them on October 15th)

-- At the same time, he proposed another process for achieving a bipartisan plan, calling for a commission to be named by Speaker O'Neill, majority leader Baker and the President.

Agency Cuts

- Abolition of the Departments Energy and Education will not only allow for budget savings but also help return decision making on important energy production and pricing questions to the market and, on educational policy, to parents, teachers and state and local authorities where they belong.

- The President's proposal calls for across-the-board savings of 12 percent in discretionary, non-defense spending for most departments and agencies of government. Certain agencies, like the VA and those involved in law enforcement are exempt.

HOW IT WORKS IN CONGRESS

* President Reagan's September 24th proposals for a second round of budget cuts will be taken up by Congress principally through the appropriations process.

* Unlike the first round, decided in a single vote on an omnibus reconciliation bill, the second round will not likely be decided in a single up-or-down test.

  — if Congress procedes as usual, the cuts will be taken up in a succession of 13 different appropriations bills.

* Not one of these 13 has yet become law.

  — government now funded by a continuing resolution, which generally authorizes spending for the new fiscal year at levels permitted in fiscal '81. This is temporary authority, until November 20th.

* When the President announced the second round, the House had passed nine of the 13.

* The Senate had passed only one but the Senate Appropriations Committee agreed to reconsider all 13 in light of President's additional proposals.

* After each House passes its version of one of the 13 bills, House-Senate conferees will meet to iron out differences.

* If this process results in appropriations bills the President thinks are too high, he has made it clear he will veto them. President Reagan has warned Congress not to send him "budget-busters."

* Should the process necessitate numerous vetoes and the rewriting of bills, it may drag on beyond November 20th, requiring a second continuing resolution. This would provoke controversy, with result at this time unpredictable.

* In addition to the appropriation bills, the second round requires legislation to:

  — authorize user fees, which would gain revenues of about $1 billion.

  — reform entitlement programs (except Social Security) to achieve budget savings of about $2.6 billion in fiscal '82.

  — revise tax codes to eliminate obsolete tax incentives and ensure against abuse, adding about $3 billion to tax collection.

GENERAL BUDGET REVISIONS

(Summary)

"Our immediate challenge is to hold down the deficit... A number of threats are now appearing that will drive the deficit upward if we fail to act....

"Our government must return to the tradition of living within our means and must do it now. We asked ourselves two questions — and answered them: 'If not us - who? If not now -when?'...."

Ronald Reagan
September 24, 1981

Two Categories

- 12% across-the-board non-defense cuts
- Defense Appropriation Cuts

— To prevent overruns in fiscal '82, reduce the deficit and balance tne budget by fiscal '84

— To provide relief from high interest rates and continue the program for economic recovery

— To continue to reduce the size of government while maintaining commitments to essential services and strengthened national defense.

— Anticipated savings:
  - $10.4 of the $16.0 billion for fiscal '82;
  - $10.3 of the $28.3 billion for fiscal '83;
  - $9.8 of the $35.3 billion for fiscal '84.

GENERAL BUDGET REVISIONS

* In his September 24th speech, the President called for additional budget savings through revisions in spending plans for most major departments and agencies of government — both defense and non-defense.

  — for defense, $13 billion of additional savings are called for from fiscal '82 to '84

  — in non-defense agencies (a few are exempt) a 12 percent across-the-board cut is required in non-entitlement, discretionary spending

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Defense Cuts

* The $13 billion in additional savings amount to:

  — $2 billion in '82, a cut of 1 percent to $181.8 billion

  — $5 billion in '83, down 2 percent to $214.9 billion

  — $6 billion in '84, down 2.4 percent to $242.6 billion

  Note: These cuts come in addition to $3.5 billion in waste already identified and cut in the first round.

* These cuts do not compromise the goal of restoring American military strength. The 5 point plan for strategic modernization announced by the President on October 2 can be funded at these budget levels.

* Cutbacks required by the additional budget savings will come in areas with least effect on readiness posture:

  — units already scheduled for elimination will be retired early

  — selected procurement programs will be delayed and stretched out where permissible

  — non-essential construction projects will be delayed or cancelled

* Even after the additional savings, fiscal '82 defense spending will be 13 percent higher than last year ($181.9 billion compared to $160.4 billion)

* By FY 1984 defense spending will be 51 percent higher than fiscal '81 levels.

Non-Defense Cuts

* The 12 percent across-the-board reductions in discretionary spending will apply to all agencies and programs except:

  — entitlement programs - where formula adjustments will be proposed to realize further cuts

  — Veterans Administration Hospital Care

  — Immigration and Naturalization

  — law enforcement agencies like the FBI, U.S. Attorneys' offices and the like

* The 12 percent cuts will save $8.4 billion in fiscal '82. Even after they are in place, spending for non-defense programs will be 5 percent higher than in fiscal '81, $ 527.4 billion compared to $502.0 billion.

ENTITLEMENTS

(Summary)

"...In the last two decades, we have created hundreds of new programs to provide personal assistance. Many of these programs may have come from a good heart, but not all have come from a clear head. And the costs have been staggering..."

- Ronald Reagan
September 24, 1981

Entitlement Reform -

— To better target services to the needy and away from the undeserving who should not be eligible for benefits;

— Entitlement spending is one of largest and fastest growing items in the budget, and this runaway growth must be brought under control.

— Interagency working group to forward reform recommendation to Congress in October.

— With exception of Social Security, all entitlement programs will be examined.

— Anticipated savings:
- $2.6 billion by end of fiscal '82;
- $26 billion by end of fiscal '84.

ENTITLEMENT REFORMS

* Planned additional budget savings in a variety of automatic spending (entitlement) programs other than social security:

  — $2.6 billion in fiscal '82, and

  — $26 billion by end of '84

* Programs affected are assistance programs where spending levels are determined by eligibility formulas, not appropriations levels. People who are eligible under the formulas are entitled to benefits, so spending is automatically pegged to number of recipients and benefit levels. Eligibility formulas are too broad and permit non-needy middle and upper income people to receive assistance, spending growth skyrockets.

  To avoid this, the following programs are under review:

  — Medicare and Medicaid
  — Food Stamps and AFDC (Aid to Families with Dependent Children
  — Subsidized housing
  — Railroad retirement and other non-SS federal pensions
  — Student loans

* Need to slow runaway program growth, from $8 billion in 1955 to $188 billion in 1982 — 2300 percent.

  — Congressional action during the 70s expanded programs and eligibility criteria, opening them up to abuse.

Growth In Spending

* The fiscal '82 increase in entitlement spending — even arter the first round of cuts — is the biggest ever. From 1970-1981:

  — Food stamp outlays rose more than 1800%
  — School nutrition outlays rose more than 800%
  — Housing assistance outlays rose more than 1300%

* Total payments for individuals increased at a rate nearly double that of overall budget growth and 2.5 times faster than GNP.

* Entitlements this year will account for nearly 48% of all federal spending (up from 35% in 1970 and 22% in 1956).

Food Stamps

* Costs have doubled in the past three years. Almost one out of 10 Americans (22 million) participate in the program this year. There are currently more than 30 million Americans who are eligible.

* Growth in the food stamp program <u>not</u> related to rising unemployment rates.

  — <u>In 1975,</u> at the peak of the recession, there were <u>7.8 million unemployed</u> and <u>17.1 million Food Stamp participants.</u> At the <u>1980</u> peak of <u>7.5 million unemployed,</u> the program had grown to more than <u>22 million recipients.</u>

* <u>Food stamp fraud,</u> waste and abuse is estimated as high as <u>$1 billion a year</u> — about 10% of the program's annual budget.

  — Since 1975, government has recovered about $6.5 million through seizures, court-mandated and voluntary returns in illegally held food stamps. 2,080 indictments resulted.

    - in 1981, $1,198,050 in counterfeit food stamps was confiscated as a result of just one food stamp investigation in one city, Chicago.

<u>School Lunches</u>

* In last decade, federal subsidies for school lunches multiplied more than five times (from $576 million in 1970 to $3.1 billion in fiscal '80)

  — Last year, subsidized lunches were served to about half the total student population in 90% of the nation's schools.

  — In one of the most affluent suburbs in the nation (Grosse Pointe, Michigan) the federal government provided $94,000 for subsidized lunches last year.

<u>Medicaid</u>

* Cost of federally-supported medical assistance programs has risen more than 450% since 1970 — now averages $1300 a year for each eligible beneficiary.

* In 1977, HEW Inspector General estimated $4.1 - $4.6 billion worth of fraud, waste and abuse in Medicaid.

<u>Need For Reform</u>

* <u>Social Security is not affected.</u> Any changes will come from bipartisan Task Force recommendations in 1983.

* Reforms and savings can be accomplished while keeping commitment to "safety-net" for truly needy.

  — <u>Even after reforms</u> and additional savings are enacted:

- almost 4 million more will receive food stamps than in 1975 — about 21 million in 1982.

- about 40 million low-income people will receive over $50 billion in cash and in-kind benefits from 8 major federal assistance programs.

- entitlement spending growth will be slowed but not stopped, rising at about 4 percent per year through 1984.

- government will subsidize about 100 million meals per day, 1 in 4 to schoolchildren, in 1982.

- aid to elderly will average about $15,000 per couple including medical assistance.

The Safety Net

* Commitment to preservation of "safety-net" must include reforming it. Benefits must be targetted better so there will be more assistance available to the truly needy and less lost to fraud and abuse.

  — Fraud in food stamps (including black market sales) already totals about $1 billion a year. Could be more.

  — Medicaid so poorly managed that costs have risen 450 percent since 1970 — now averages $1300 a year for each eligibile beneficiary.

  — Eligibility formulas allowing non-needy to benefit reduces amounts available to truly needy.

    - limiting number of recipients to only truly needy while allowing moderate spending growth, could allow larger assistance to those in real need.

* When review is complete, legislation to Congress in October. Passage sought this year.

  — Reconciliation act this summer fell short of original entitlement reform proposals by $2.8 billion. Some parts of original plan not passed will be resubmitted in October package.

REDUCED FEDERAL BORROWING AND LENDING

(Summary)

"....In just the past decade, our national debt has more than doubled. And in the next few days it will pass the trillion dollar mark. One trillion dollars of debt — if we as a nation need a warning, let that be it....

...Federal loan guarantees have become a form of backdoor, uncontrolled borrowing.... They are a major factor in driving up interest rates. It is time we brought this practice under control...."

Ronald Reagan
September 24, 1981

Reducing Federal Borrowing -

— Accomplished through reductions in spending and lessening the deficit.

— Decreases federal presence from credit markets thus freeing up capital and lowering pressure on interest rates.

— Anticipated Savings: In fiscal '81, the cost of carrying the debt was $95.5 billion, in fiscal '82 it will be $114.2 billion. By decreasing the debt, these costs will begin to lessen.

Reductions in Federal Loan Guarantees -

— To lessen the federal presence in the credit markets to help bring about lower interest rates.

— To provide for better targetting of loans in order to avoid both high rates of default and subsidies for those who can obtain credit without them.

— Anticipated Savings: $21 billion in fiscal '82, additional savings for fiscal '83 and '84.

REDUCING FEDERAL LOAN GUARANTEES

* President Reagan proposed a $21 billion reduction in federal loan guarantee commitments for fiscal '82. More reductions planned for '83 and '84.

* Current massive levels of federal lending activity cause 3 major problems:

  —they contribute to high interest rates
  —they help to crowd out competition for credit in the loan markets
  --they add to the cost of government, directly through non-collection of debt and indirectly, by keeping interest rates and hence the cost of interest on the national debt high.

* Direct federal borrowing, coupled with federally subsidized borrowing will absorb almost half of all the dollars loaned to Americans in 1981 — about $153 billion.

* As a result, unsubsidized borrowers are crowded together in competition for the remaining pool of credit. This creates an artificially high demand for a limited supply — putting upward pressure on interest rates.

Background

* What are federal loan guarantees

  — Government "co-signs" a loan between borrower and an established lender (bank), promising to pay (guaranteeing) the loan in case of default by the borrower.

* Two types of loan guarantees

  — Unsubsidized: Government simply guarantees payment

  — Subsidized: Government not only guarantees payment, but provides the borrower with below market interest rates by paying the lender the difference between the loan rate (borrower's cost) and the market rate (lender's cost).

CONTROLLING SPENDING AND DEFICIT OVERRUNS

- roposing a second round of budget savings, the President
  to prevent overruns in federal spending and the deficit.

- nchecked, overruns would require continued excessive federal
  wing in the private lending markets, keeping up the pressure
  terest rates.

  - High interest rates are largest single remaining obstacle to economic recovery, growth, and the creation of jobs.

  - If additional savings not enacted, federal government will be in private credit market, borrowing $80 billion for the third year in a row.

- runs have plagued the federal budget process. Repeated
  ility of government to meet its own spending goals has
  ted skepticism among public, on Wall Street.

  - In last 2 years, federal spending has exceeded Presidential budget requests by about $48 billion in each year.

  - In 1976, Congress first started setting targets for federal spending in a May budget resolution. In last 2 years, Congress has overspent its own spending targets, which partly accounts for the $48 billion overrun..

- e overruns threaten again this year.

  - The original March 1981 spending estimate of $695.5 billion for fiscal '82 had grown to $705 billion in July, and to as much as $722 billion in September — an overrun of $27 billion even before the fiscal year began. The reasons are:

    - high interest rates raising costs of federal debt.

    - failure of Congress to enact some $2.8 billion in entitlement savings initially requested by the President.

    - increased outlays for certain entitlement programs, like food stamps and Medicare.

    - increased outlays for farm subsidies - record crops have driven prices down and subsidies up an estimated $2.5 billion.

- rrun threat had to be countered to restrain deficit, hold
  rowing down.

ELIMINATING TWO DEPARTMENTS

(Summary)

"...There is only one way to shrink the size and the cost of big government — that is by eliminating agencies that are not needed and are getting in the way of a solution..."

-Ronald Reagan
September 24, 1981

Energy -

— To fulfill the President's promise

— To restore free market forces to energy production

— To eliminate needless bureaucracy

— Anticipated savings: $1.5 billion and a reduction of 6,500 federal jobs.

Education

— To fulfill the President's promise

— To eliminate burdensome regulation

— To restore control over educational policy to parents, states, and localities

— Anticipated savings: Precise dollar savings unknown but small beginning already made by cutting 100 pages of regulations through use of block grants.

DEPARTMENT OF EDUCATION

* Dismantling the Department of Education, created only one year ago will achieve the following:

    — reduced federal spending and intervention in schools and the educational responsibilities of parents and families

    — greater responsibility in states and localities for setting educational policy

    — reduced regulation and paperwork requirements for local school administrators

* The Department was never needed in the first place. Like its ancestor, the 1867 Department of Education — abolished before its first birthday — we'll be better off without it.

* Block grants are a much better way to channel federal funds to state and local governments for educational assistance.

* The small beginning Congress already made on educational block grants, consolidating about 30 programs and about 3.5 percent of the Department's budget, shows what can be achieved:

    — eliminated about 100 pages of regulations in tne Federal Register

    — eliminated need for about 200,000 pages of grant applications, 7000 pages of financial reports, and 20,000 pages of program reports flooding the Department annually.

    — regulations abolished included:

        - one-half page of instructions — 11 paragraphs — on how to mail a letter to the Department.

DISMANTLING THE DEPARTMENT OF ENERGY

* During his campaign, the President promised to dismantle the Department. He is keeping his promise.

* Consistent with the President's energy policy, announced last July, which stresses importance and efficiency of the marketplace. Bureaucracy has yet to increase oil production one drop.

* The fiscal '82 budget already terminates or greatly reduces certain major programs.

  -- The Fossil Energy Program, previously funded for $1.5 billion, was cut to $441 million in the first round.

  -- DOE regulatory agencies -- such as the Economic Regulatory Administration -- have been cut by 50%, providing a savings of $100 million.

* Reduction of government's role has already begun to pay off.

  -- Earlier this year, the President decontrolled oil, restoring free market forces and incentives. Since then:

    - drilling and exploration is up -- over 4000 exploratory rigs active in 1981, twice the number in 1977.

    - gasoline prices have dropped from an average of $1.38.8 a gallon in January to an average of $1.35.3 in July.

* Market forces accomplished what government could not.

  -- Petroleum consumption is down. First half of 1981 shows drop of 6.3% compared to similar period last year; down 14.5% from 2 years ago.

  -- Conservation achieved through market forces, not government.

  -- Increased production and conservation have led to a drop in oil imports. Today's daily average of 5 million barrels is 10% lower than in 1980 and 40% lower than 1977 -- aiding our balance of payments problem and lessening our dependence on unreliable sources.

* Reduced government role helps balance the budget.

  — By end of fiscal '84, dismantling DOE will save an estimated $1.5 billion and allow a personnel cut of 1/3, (6500 employees).

  — Since fiscal '72, staff for energy programs has doubled (from 8,300 to 17,800) while budgets have quintupled (from $2.7 billion to $13.8 billion).

  — In addition, DOE presently has 115,000 individuals under contract (consultants, etc.) in government owned facilities.

* America's energy needs will be better served.

  — Deregulation saves time and money. Elimination of reporting requirements under the Emergency Petroleum Allocation Act alone will save industry 700,000 man-hours and at least $14 million in unnecessary paperwork — time and money better spent in energy production.

  — Drilling activity is up and the trend toward decline in domestic production has been halted.

  — By the end of August more than 22,000 wells were producing oil — a 40 percent gain over 1980.

  — Important DOE functions — though transferred to other departments — will continue. Examples:

    - basic scientific/engineering research
    - some conservation programs
    - the strategic petroleum reserve
    - both civilian and military nuclear energy programs.

REVENUE ENHANCEMENT

(Summary)

Now that we have provided the greatest incentives for saving, investment, work and productivity ever proposed, we must all ensure that the taxes due the government are collected and that a fair share of the burden is borne by all....

When the federal government provides a service directly to a particular industry or group of citizens, I believe that those who receive benefits should bear the cost...."

Ronald Reagan
September 24, 1981

Tax Code Revision -

— To eliminate abuse and certain obsolete incentives from the tax code.

— To ensure that, as the largest tax cut in history takes effect, everyone pays his fair share.

— Anticipated revenues:
- About $3 billion in fiscal '82;
- Total of $22 billion by fiscal '84.

User Fees -

— To assess to users of certain federally provided services - yacht owners, private pilots, certain commercial interests - a greater share of the costs.

— Anticipated revenues: $1 billion in fiscal '82 alone.

Debt Collection -

— To recover money owed the government either in loan or tax payment deliquencies.

— Anticipated revenues: $1 billion in fiscal '82 alone.

TAX CODE REVISIONS

* With certain revisions in the tax code, the President believes the deficit can be reduced by $3 billion in fiscal '82 and a total of $22 billion over the next 3 years.

  —Revisions intended to curtail abuses and obsolete incentives in the code

  —Revisions will be sent to Congress in legislative proposals during October.

* Revenue enhancements will <u>not be achieved by raising taxes;</u> only by improving ability to collect taxes honestly due to ensure that all pay their fair share and by eliminating obsolete incentives.

  — Items under review for possible revisions include:

    - business tax accounting rules dealing with completed contract method (could raise additional $1 billion this fiscal year.)

    - certain residential and business energy tax credits.

    - tax-exempt industrial development bonds

    - modified co-insurance arrangements by life insurance companies.

    - tax threshold for unemployment compensation.

    - corporate tax collections schedules.

    - changes in administrative rules covering IRS enforcement and collection.

USER CHARGES

The Problem

* Certain groups — like owners of yachts and private jets, commercial shipping interests and airlines — receive expensive services from the federal government while paying little or none of the cost.

* The following services alone will cost the federal government $3.3 billion in fiscal '82:

  — $525 million for the Army Corps of Engineers to maintain river harbors, channels, locks and dams for the barge and maritime industries;

  — $800 million for the Coast Guard's vessel inspection, search and rescue, and other navigation and safety programs;

  — $2 billion for the FAA to license pilots, run the air traffic control system and perform various other safety activities.

* These vital services make air and water transportation possible, and protect lives and property. But many of the benefits accrue to clearly identifiable individual and business users, rather than to the general public.

* These are not really "low-cost" or "free" services. They're subsidized — paid for by everyone out of general tax revenues.

* The inland waterway and aviation user charges now in effect don't come close to covering the costs. This Spring, the President proposed recovering a major portion of these costs through user charges, as part of the Economic Recovery Program. However, the Congress has so far ignored those recommendations.

The Plan

* User charges, like the present small tax on fuel used by barges, place the costs of providing a service on the users of that service, so the general public doesn't have to foot the bill.

* President Reagan has renewed his request to Congress for user charges.

  — Legislation would recover an additional $980 million in fiscal'82, more in subsequent years.

  — Plan would phase in user charges, to prevent undue disruption to affected industries.

  — Even when fully implemented, plan would still cover less than total costs of these programs, since maintaining transit lanes for commerce and defense purposes is a legitimate public obligation of the federal government.

  * Failure to adopt the plan would result in loss of $4.5 billion in receipts over the next three years, add to budget deficit.

  * The proposal is also good transportation policy. User charges that recover the costs of government services prevent excessive subsidies that unfairly favor one form of transportation over another.

STEPPED UP DEBT COLLECTION

* In addition to proposing reduced levels of federal loan guarantee activity, the President has also ordered a more aggressive effort to collect debts due the federal government.

* A total of $175 billion is currently owed, with at least $25 billion of that amount delinquent or in default.

  — about half the total is delinquent tax payments

  — about $8 billion is delinquent or defaulted loans, much of this student loans.

  — most of the indebtness affects four agencies: HUD, Education, IRS and the VA

* The existence of such large amounts of unpaid debt represents more than just income deferred for the federal government. It increases federal spending:

  — the interest alone on the $25 billion indebtedness costs the taxpayer over $10 million per day

  — in fiscal 1979 alone, over $1 billion in bad debts were written off, with the taxpayers of course making up the difference.

* Over the next 3 to 4 years, about two-thirds of the total, or $16 billion, could be recovered with a more aggressive debt collection commitment. Agencies have been ordered to implement a program that will include:

  — detailed review of current debts owed and setting of timetable for collection

  — designation of lead official to administer the effort in each department

  — coordination with and systematic reporting to OMB on progress.

  — development of plan to avoid repetition of problem in the future

* Legislation to facilitate debt collection has been proposed to Congress and is now under condiseration.

REDUCTIONS IN FEDERAL EMPLOYMENT

* 6 1/2 percent of the federal work force equals about 75,000 employees out of a total 1.15 million non-defense work force (1982 ceilings).

  — in addition to Defense, some other departments and agencies will be exempt, or subject to reduction goals of less than 6 1/2% (e.g. State, Customs, FBI, INS, Secret Service and IRS). The White House staff and Executive Offices of the President are not exempt.

* Force reductions will be phased in by 1984:

  — retirement and voluntary terminations will account for much of the reduction. There is normally about a 10 percent average turnover annually.
  — the planned permanent reductions represent only about 20% of the total government-wide number expected to leave through attrition during the next 2 years.

* Personnel reductions could mean an annual savings in manpower costs of as much as $3 billion.

* Reductions in the growth of government, elimination or certain programs, and streamlining of others through block grants will eliminate the need for some positions. This has already been demonstrated:

  — termination of the Regional Commissions in the Commerce Department has eliminated 60 positions.
  — HUD's Community Development Program is being streamlined into a blockgrant, eliminating the equivalent of over 300 positions.
  — extension of FCC licensing periods from 5 to 7 years will reduce staff demands in the license renewal offices

* For those whose positions will be terminated, the Administration plans efforts to assist them:

  -- the Office of Personnel Management has launched a voluntary placement program to help find opportunities in state and local government and the private sector.

  — this program has already found jobs for 1000 displaced federal employees before their termination took effect.

  — after termination, civil service rules allow for payment of severance pay and OPM has mounted additional programs to help match those terminated with any new openings in the federal government.

REDUCTIONS IN FEDERAL EMPLOYMENT

(Summary)

"To achieve further economies, we will shrink the size of the non-defense payroll over the next three years by some 6 1/2 percent..."

-Ronald Reagan
September 24, 1981

75,000 Reduction In Non-Defense Workforce -

— To reduce the size and cost of the federal bureaucracy

— To reflect the shift away from centralized bureaucracy to block grants and greater state and local program control.

— Anticipated savings: As much as $3 billion in manpower costs.

SOCIAL SECURITY

* The President proposed Social Security changes in May at Congress' request. Were to have formed basis for bipartisan effort to save system.

* Majority leaders in House politicized issue, made plan an object of partisan attack instead of bipartisan debate.

* On September 24th, President Reagan set his plan aside, proposing bipartisan task force in its place, to report early in 1983.

* Task force is <u>not a study commission, but an action group. Purpose not only to develop a plan, but to forge a political consensus.</u>

  — system's problems are well-known. Many study groups in past have made good recommendations for reform.

  — unlike past panels, this one contains members of House and Senate who can work with colleagues to develop bipartisan proposals that won't tempt Congress to play politics with system.

<u>Crisis is real</u>

* Unless short and long-term problems are resolved, the Social Security system will collapse.

* Largest of its 3 trust funds will be bankrupt by end of '82 unless action taken.

  — Old Age and Survivors' Insurance (OASI) Trust Fund from which Social Security checks most familiar to Americans are drawn.

* Plan for <u>interfund borrowing</u> can keep OASI solvent on temporary basis. <u>Not a long-term solution.</u>

  — Long-term deficit of <u>$1.5 trillion</u> projected for OASDI over next 75 years.

<u>Higher Taxes Not The Answer</u>

* Americans already taxed to the limit.

* Social Security tax increase passed in 1977 was the largest in peacetime history. Told when passed it would keep system solvent until 2030.

  — 5 years later, OASI on verge of bankruptcy.

  — Average American worker pays 6.6 percent of income -- $913. a year in Social Security taxes. Employer matches with equal payment.

  — Present trends will lift this combined tax rate to 15.3 percent by 1990 and employers and employees would each pay an average $1,873 a year.

* Problem is partly demographic. Ratio of workers to retirees getting smaller.

  — in 1950, ratio was 16 workers to 1 beneficiary.
  — now ratio is 3.2 to 1.
  — will get smaller still, as population ages.

President Reagan's Fall proposal

* President Reagan's commitment is to save the system without reducing benefits for those now dependent on them.

* On September 24th, he renewed that commitment, setting his original proposal aside and making the following 3 recommendations to Congress:

  — establishment of the bipartisan task force. Speaker O'Neill and Majority Leader Baker are working with the Administration on task force structure.

  — authorization of interfund borrowing as a temporary measure - to allow OASI to use funds from the other 2 funds, the Disability Trust Fund and the Hospital Trust Fund (Medicare).

  — restoration of the minimum benefit for low-income beneficiaries who depend on it. (Senate Finance Committee approved this the night the President spoke.)

THE REAGAN PROGRAM FOR MODERNIZATION OF U.S. DEFENSES

*On October 2nd, President Reagan announced a comprehensive 5 point program for strengthening U.S. strategic forces. The program has one overriding purpose:

— Restoring the strategic balance to maintain U.S. ability to deter war.

* The President recognized continuation of present trends would lead to a widening strategic imbalance (opening a "window of vulnerability") since:

— Soviet trends are in the direction of continued massive build-up. Over the past 15 years, they have outspent the U.S. 3 to 1 on strategic systems.

— U.S. trends have been in the direction ot slow, patchwork improvement of strategic forces. Only one new strategic system (Minutemen missile) has been deployed in 20 years. (Became operational in 1962). The Trident submarine will not be deployed until late 1982.

* President Reagan's program will reverse these trends and accelerate modernization of every major component of our strategic force. Priority will be put on the need to ensure survivability and endurance both for:

—Land, sea, and air-based strategic weapons

—The military communications and command system.

* With this program, President Reagan has announced the first comprehensive and coherent strategic forces replacement and modernization program in 20 years.

* There are 5 interrelated parts of the program:

—Improvements in communications and command facilities

—Modernization of bomber fleet (B-1 and "Stealth") along with major deployment of cruise missiles

—New sub-launched missiles (Trident D-5) and hundreds ot sea-launched cruise missiles

—New ICBM deployment (MX) with steps to reduce vulnerability

—Early warning, air-defense and other improvements

* When President Reagan took office, several weapons decisions were pending and concerns were mounting that a "window of vulnerability" would open in the near-term, exposing U.S. strategic forces to first-strike threats.

— The threat of vulnerability applies to the strategic system as a whole, not just to its land-based component. The President has proposed modernization of the system as a whole.

— Modernization of each of the 5 components, from the increasingly vulnerable land-based ICBMs to the relatively secure submarine-launched missiles, will ensure the continuation of a U.S.-Soviet strategic balance and the continued credibility of our deterrent forces.

— Compared with today's forces, the program will roughly double the number of survivable U.S. strategic weapons by 1990.

— During the 80s, new systems will be deployed to ensure the early strengthening of our capabilities.

- air-launched cruise missiles in a squadron or B-52s next year. (3000 cruise ultimately planned)

- one new Trident submarine constructed yearly.

- sea-launched cruise missiles on general purpose submarines in 1984.

- MX missiles in existing but beefed up silos by 1986.

- decision in 1984 on long-term basing mode for additional MXs. Options are (1) continuous airborne patrol (2) deep underground. (3) modern ground base defense

- first squadron of B-1s by 1986, 100 to be built.

— Townes Commission (defense experts) reports that no known system exists for guaranteeing invulnerability for land-based ICBMs. While R&D continues, first batch of MXs will replace aging Titan II (1950s technology) in existing silos. Silos will be superhardened to help thwart Soviet capabilities.

- superhardening can double silo's blast resistance, making it secure from all but a virtual direct hit

- Soviet accuracy improving, but not yet to the point of being certain of a direct hit.

- MX missile to be ready by 1986. Use of super-hardened silos will permit immediate deployment of this more sophisticated missle.

- Long-term basing mode research continuing — goal of survivable ICBM force into 1990s and beyond

- Multiple Protective Shelter ("Racetrack") cancelled because it could not have guaranteed survivability.

- There are no limits (treaty or otherwise) on numbers of Soviet missiles. In the time needed to construct 4600 shelters Soviets could build and stockpile enough missiles to strike all 4600.

— Waiting for "Stealth" bomber development before modernizing our bomber force is too risky. Rather than gamble on an aircraft still in the planning stage, the B-1 will fill the gap.

B-1 fulfills two missions:

- Near term: need to replace aging and more vulnerable B-52s ('50s design) until Stealth is operational.

- Long-term: will not become obsolete — need for a conventional bomber to cary cruise missiles, even after Stealth comes on line (1990s). Eventually all B-52s will be retired.

— The proposed cost of the entire modernization program can be borne by defense spending levels already proposed by the President.

- cost in fiscal '82 will be $22 billion — $180.3 billion through fiscal '88.

- cost each year will amount to no more than 15% of entire Defense budget. This compares to 20% spent for strategic weasons during the early 60s when we built many of the forces tnat still exist today.

— In addition, so the strategic balance will not tilt against the U.S. again as it has in the last 15 years, the President's program includes:

- R&D on strategic systems beyond those in his present program.

- continuous upgrading of deployed systems as technologies evolve.

A SUMMARY OF THE REAGAN STRATEGIC PROGRAM

COMMUNICATIONS AND CONTROL

* Communications and control systems must be as strong, reliable and survivable as the modernized systems they will support.

* The ability to control nuclear forces effectively — during and after a nuclear attack against us — is essential to a credible deterrent. Credibility requires:

  — Timely warning: satellite and fixed and mobile radar systems will be upgraded

  — Command centers: to direct a response to an attack, additional mobile, ground and air-borne command centers and communications-links would be added to our present system, reliant on land-based, stationary sites.

  — Survivable communications links: to ensure reliable transmittal of orders to our forces, new satellite communications systems will be developed, as well as more secure (low frequency) receivers for bombers and upgraded links with submarines.

MANNED BOMBER FLEET AND AIR-LAUNCHED CRUISE MISSILES

* Reliance on an aging, potentially vulnerable B-52 bomber force until the Advanced Technology ("Stealth") bomber could be deployed ran too great a risk because:

  — The B-52 was developed in the 50s (last one built in '62). Decreasing ability to penetrate Soviet defenses or to survive a first strike.

  — The Stealth bomber is an unproven design concept. Most optimistic assumptions are it could not be built before end of the 80s.

* More than a design concept, prototype B-1s have been built and flown. An upgraded version will be built with the first squadron (12-16 out of a planned 100) operational in 1986.

* The President believes the B-1 is necessary during critical second half of the 1980s, while the Stealth bomber can provide continued ability to penetrate Soviet defenses into the next century.

* In addition, newer B-52s will be modified to carry cruise missiles.

  — Ultimately, B-52s and B-1s wil carry over 3000

  — Cruise will be deployed on first B-52 squadron in '82

SEA-BASED FORCES

* The President's program for modernization of sea-based forces recognizes that they are currently the most survivable by the Triad. The program to further stengthening and modernize these forces includes:

  —Development of the Trident ballistic missile submarines will be continued at a steady rate of one per year, at least from 1981-87, with probably of more in later years.

    - development of the larger and more accurate D-5 (Trident II) missile for deployment beginning in 1989.

    - deployment of hundreds of sea-launched cruise missiles general purpose submarines.

LAND-BASED FORCES

* The President's approach to ICBM modernization includes:

  - developing and deploying at least 100 MX missles

  - deploying at least one-third of these by 1986 in existing silos superhardened to withstand much greater blast forces.

  - retiring all existing Titan II missiles.

  - pursuing development of three other basing modes: continuous airborne patrol aircraft, Ballistic Missile Defense, and deep underground basing. One or more of these modes to be selected by 1984.

* The Multiple Protective Shelter basing mode (the so-called "racetrack") for the MX missile will be cancelled. The argument that secretly dispersing 100 missiles among 1000 shelters (or 200 in 4600 shelters) would give our land-based force a greater probability of surviving a first-strike nuclear attack is nullified by the Soviet's capability to proouce missiles faster than we can build shelters.

* The advantage of the MX over the Titan II and the Minuteman missiles is greater accuracy, larger payload, improved guidance system, less maintainance and less prone to on-station accidents.

EARLY WARNING AND AIR DEFENSE

* The President's program includes:

  - coordination with Canada to upgrade the North American air surveillance network

  - replace five squadrons of aging F-106 interceptors with new F-15s

  - build at least six additional AWACS airborne surveillance aircraft

  - pursue development of an operational anti-satillite system

  - research and development on ballistic missile defense for land-based ICBMs along with development of new technology for space-based missile defense systems.

  - expand our civil defense program in coordination with the Federal Emergency Management Agency (FEMA).

* We have large gaps in our strategic defense systems because we have virtually ignored them for over a decade. The North American air surveillance network has declined, our air defense interceptors are obsolete, and our anti-satillite and ballistic missile defense programs have lagged behind the Soviets. The President's program will end these years of neglect.

* In addition, so that the strategic balance is never allowed to tilt against us as it has in the last 15 years, the President's program includes:

  - research and development on strategic systems beyond those in his current program

  - continuous upgrading of effectiveness of systems while deployed.

Q. What are the chances of getting these latest cuts through Congress?

A. The Administration is confident that Congress will move favorably on the second round of cuts.

Congress already has shown its willingness to support the President's Economic Recovery Program by voting favorably on both his tax cuts and on the first stage of his budget cuts. These new savings are a logical continuation of that same program.

The fact is, sky-high interest rates remain the single largest remaining obstacle to economic recovery, growth, and the creation of jobs. If the Administration is to succeed in bringing interest rates down, the deficit must be kept under control. Most members of Congress realize this.

They also realize that passage of these cuts is the only way the President can balance the budget by fiscal '84, something no other Administration has been able to do since 1969.

Grassroots support for the budget savings is strong, and the Administration believes this will be reflected in the Congressional vote. If it is not, the President has vowed to veto any appropriations bills that he considers to be "budget busters".

Q. How much of the savings needed to achieve a balanced budget in fiscal '84 is contained in the new budget reduction package?

A. Seventy percent (70%) of the $115 billion in additional budget savings needed over fiscal 82-84 is contained in the fall plan, which calls for $80 billion in federal spending cuts.

When these cuts are in place, the budget process will continue. In fiscal '83, the President will propose $11.7 billion in added savings, and an additional $22 billion in budget reductions will be proposed in fiscal '84.

The cuts President Reagan is proposing now, and those he will propose in the future, will enable him to balance the budget by 1984, something we have been able to accomplish only once in the last 20 years.

Q. If it was obvious to the Administration that the funding levels in the reconciliation bill were too high, why were they accepted in the first place?

A. The budget bill which President Reagan signed this summer contains $35 billion in savings. It cut the government's rate of growth nearly in half — the greatest reduction in federal spending in our nation's history.

The reconciliation bill was significant in that it made changes in the law where necessary to bring about lower spending. President Reagan obviously was pleased with the bill, and he was encouraged by the bipartisan support it received.

But while the bill represented an impressive beginning to the Economic Recovery Program, it was not the full-fledged offensive against government over-spending that the President originally requested. Some of the savings in the Administration's budget proposal were not included in the legislation, and Congress has taken actions since the summer that could add even more to the cost of government.

The second round of budget cuts is crucial if we are to stay on the road to a balanced budget and lower interest rates. Without these further reductions, our deficit for 1982 will be increased by some $16 billion. The estimated deficit for '83 and beyond will increase proportionately if we do not take action now.

Q. Will the Administration seek a third round of budget cuts for fiscal '82 if the fall program does not bring down interest rates?

A. No, not this year. Once the budget authority has been voted, it would be very difficult, if not impossible, to revise it.

Further, entitlements must be changed early in the year or it will be too late -- both from a legislative and from a practical standpoint -- to reduce outlays in these programs in 1982.

Our only real chance to hold the line in the '82 budget is now. That's why the President proposed action at this time.

Q. Why have the fiscal 1982 outlay estimates increased so rapidly since July?

A. Unforseen costs in a variety of areas caused the estimate to be revised.

The largest adjustment -- $5.6 billion -- can be attributed to the unexpectedly high interest rate the government must pay on the the natural debt this fiscal year. We will pay 12.7 percent, instead of our original estimate of 11.3 percent.

About $2.8 billion was added to the spending estimates because Congress failed to make all the cuts in Medicaid, student loans, school nutrition and other entitlement programs, that the President originally requested.

The failure of Congress to act on President Reagan's Social Security plan increased the estimate by $3.8 billion.

A fall in the price of wheat and feed grains and higher dairy production costs triggered higher support price payments under the law, resulting $2.4 billion increase.

Extra costs associated with Conrail, the Sinai peace-keeping force, lower naval petroleum reserve receipts and a variety of other developments added $1.5 billion to the estimates.

Another $1.5 billion had to be added because of the higher Medicare and food stamp costs -- even after reconciliation.

These unexpected costs are not unusual. As in the past years, they threaten a classic case of overruns. The difference between this and other years, however, is that President Reagan has moved in a timely and decisive way to deal with the problem.

Q. Has the Administration reneged on promises it made to members of Congress who helped win passage of the first budget cuts?

A. No, the reconciliation process is a very complex one, a process of accomodation involving many people, interests and perspectives. Adjustments and trade-offs were made among Members and between the House and Senate as part of the democratic process.

But there was never any understanding that the authorization ceilings that were included in the reconciliation bill would be fully funded if they were over the Administration budget.

The bill that was passed saved $35 billion and went a long way toward our target. But it did not produce all the savings required, nor <u>could</u> it prevent serious overruns that threaten to drive up the deficit and interest rates.

Q. How can the Administration cut $2.6 billion in entitlement programs without destroying the social safety net?

A. There is absolutely no attempt on the part of this Administration to undo the safety net. The safety net represents our commitment to help the truly needy who are dependent on government. It will remain in place for those who need it. The President never suggested, however, that programs in the safety net would be immune from reform.

Some of the entitlement programs have been growing too rapidly. Medicaid, for instance, has been growing at 20 percent per year.

It seems obvious that we can meet the medical needs of the elderly and low income non-elderly at a growth rate far less than that. And regardless of the proposed cuts, spending for social programs will continue to rise, though more slowly, in coming years.

Q. How many of the 75,000 Federal jobs the Administration intends to cut by 1984 will be lost through attrition and how many through firings or RIF's?

A. Most of the reductions will come through attrition. The average annual attrition rate is about 10% (those who retire, or transfer voluntarily to non-federal jobs). Of the roughly 800,000 employees in the affected non-defense agencies, this rate would be enough to meet our goal in the first year. But, of course, not all of the jobs vacated through attrition can or should be left unfilled, if necessary programs are to be carried out.

While attrition, then, can achieve most of the reductions, some others will come from program eliminations, such as DOE and Education, as well as streamlining through block grants and the like.

Q. What will the cost to the taxpayer be in unemployment compensation, severance pay and other benefits due these employees?

A. There will be some transitional costs. There is no way to tell at this time precisely what these costs might be since the agencies are still reviewing how to implement the reductions.

However, the long term savings to the taxpayer due to the reduction in the size of the Federal government will be substantial -- as much as 3 billion on an annual basis.

Q. Why hasn't the financial community reacted positively to this new round of budget cuts?

A. The financial community has reacted positively to the President's new round of budget cuts. A broad cross-section of the community has contacted the White House to voice approval of his actions and express hope for the program's success.

The Commerce Department's survey of industrial plans for new plant and equipment investment estimates $321 billion will be spent this year on industrial expansion and improvement.

The American Iron and Steel Institute, for example,citing belief that the new tax program will make investments more profitable, reports that 24 steel companies have announced new plant modernization projects, valued at more than $5 billion, in recent months. Included in these announcements are plans that have been "on the shelf" waiting for a time when earning prospects justified commitments to proceed.

The problem is a skepticism over the resolve of Congress to continue the course necessary to achieve the President's ambitious fiscal objectives — to keep the budget plan on track for this year and in future years - to steadily reduce the federal deficit and borrowing levels to relieve pressure in the financial market — to get interest rates down and permit the recovery of economic growth, investment and job creation.

Q. How will local and state governments deal with these new budget cuts? Won't federal savings to the taxpayers be offset by increas3d state and local taxes?

A. How local and state governments adjust to the budget will vary greatly. But so far the evidence from around the country is that they are trying to deal with reductions in funds with economies of their own, so that federal savings will not be offset by increased local and state taxes.

High interest rates are severely hampering the municipal bond markets. State and local governments are now paying 11-12% tax free rates, which badly impairs their ability to raise capital. State and local governments will be among the prime beneficiaries of the new economic programs.

Of course, if a state or local government raises taxes unacceptably, taxpayers can do what they have already done at the national level — voting to change their representa- and replace it with those who will keep taxes low.

Q. But a new study by the Tax Foundation shows the states <u>are</u> raising taxes and 30 states will raise revenues by $2.5 billion a year, the highest annual statutory increase in state taxes in ten years.

A. Well, of course that $2.5 billion figure compares with federal tax reductions in the President's tax bill of <u>$280</u> billion over three years.

Q. Isn't the effort to control federal credit going to further depress those very areas of concern to the Administration and the economy — housing, agriculture, small business and foreign trade?

A. Federal credit activity, including guaranteed loans, pre-empts private markets and raises interest rates for those who don't have government guaranteed financing. Most home mortgages, most loans to farmers and small businesses, most export financing is not government supported. Funds raised with Federal guarantees, in some cases, have the same effect as increased federal spending, even though the spending doesn't show up on the government's books or in the deficit.

In the area of housing, for example, the best thing we can do for the industry and people who want to own their own homes is to get the interest rates down.

Q. How can the Administration be sure that it won't be denying a college education to some 800,000 young people, considering its proposed cuts in the student loan program?

A. The federal government cannot afford to be, nor should it be, in the business of giving subsidized loans to everyone who applies, regardless of their ability to pay.

At present, some students with the federal loans are from families whose income is as much as $100,000 yearly.

To make sure that those who really need the loans -- only they -- get the loans and grants available, the President's new plan changes the calculations under which the money is made available.

The guaranteed student loans, formerly awarded to anyone who applied, will cover only such expenses as cannot be covered by other aid or family contribution, the so-called "remaining need" formula.

In addition the Pell Grants, formerly called the Basic Educational Opportunity Grants, will be awarded under a new formula which determines how much discretionary income families have to help students.

Q. Given projected deficit overruns, why hasn't the President responded to pressure from members of Congress to repeal or diminish his tax cut plans?

A. The President believes the experience of the past has demonstrated over and over again that tax cuts stimulate economic growth.

Three examples:

—Coolidge/Mellon cuts in the 1920s

—The Steiger/Hansen amendment for capital gains reductions in 1978

—The Kennedy-Johnson cuts in 1964 and 1965.

The 1964 and '65 cuts are an excellent example — corporate and personal taxes were lowered in two stages. Opponents of the measures said tax cuts would increase deficits and prove inflationary — the same argument as today.

But the results confounded critics:

—U.S. during the 1960s had the longest economic expansion in it's history

—Unemployment declined and stayed below 5% for the rest of the decade

—Contrary to critics, federal revenues actually increased and deficits shrank

—Another key point: The personal savings rate — the fraction of after-tax personal income which is saved — rose by almost a third between 1963 and 1965, showing once again that tax cuts generate more savings and more jobs.

Q. How long will it be before the Departments of Education and Energy are out of business?

A. The Administration plans to transmit to the Congress detailed legislation carrying out the President's commitment to dismantle the Departments of Education and Energy later this fall. The actual abolition of these agencies depends upon when Congress enacts the legislation.

Both these agencies have functions that will be continued. These functions will be trans ferred to other existing government agencies with only the superflous regulatory functions and programs that don't work actually "going out of business."

Q. How much will it cost and how much will be saved when the Departments of Energy and Education are dismantled?

A. There really isn't any way at this point to put a precise dollar figure on net savings that will result from those actions.

We do know of some economies already realized through block grants in Education, including such things as the elimination of 200,000 pages of grant applications and something like 20,000 pages of program reports.

As for the Department of Energy, the estimated savings are about $1.5 billion and 6300 fewer positions (a 1/3 reduction) by fiscal '84. A number of functions, such as basic scientific research, the handling of the strategic petroleum reserve and breeder reactor research will continue under federal auspices.

But keep in mind that the motivation for dismantling the Departments of Education and Energy is not just saving money, but to eliminate government interference in matters better left to the states and localities, as in Education, or to the marketplace, as in Energy.

It is also the fulfillment of a promise the President made during the campaign.

Q. Why did the President reject further cuts in defense spending?

A. An essential goal of the President is to restore the nation's "margin of safety" on the military front.

Since the mid 1960s, the Soviet Union has engaged in the most massive military buildup in human history — spending 3 times as much as the U.S. on strategic nuclear forces. The U.S. hasn't deployed a new strategic delivery system since 1962.

The Reagan plan calls for a steady long term build-up of American forces over the next five years.

At the same time the President believes defense spending can be done more efficiently - and he has directed the Pentagon to come up with $2 billion in savings next year through a concentrated attack on waste - reductions in travel, unnecessary procurement and other military realignments. Over the three years, from now until fiscal '84, the cuts will total $13 billion — and this comes on top of $3.5 billion in non-essential defense spending already identified and cut in the first round.

Deeper cuts could impede the Administration's efforts to make military pay more competitive with private sector salaries. If the Administration does not provide larger pay raises, we will end up in the same situation we were in a couple of years ago, when hundreds of thousands of enlisted men were eligible for food stamps.

BUDGET CUTS -- ROUND II

(an illustrative speech)

If there were any doubt that America was headed on a firm, steady course toward economic recovery, those fears were laid to rest on September 24 after the President's speech. The spending reductions and other measures outlined by the President will, when enacted, restore confidence in the people's ability to rein in the federal government and control their own economic destiny.

The need to restrain federal spending extends across the entire government, and requires far more than minor adjustments here and there. The target figures announced by the President must be met, and the program enacted in its entirety.

Failure to adopt this package would signal a retreat from the bold steps the Congress and the Administration took together this year to revitalize the economy. It would be a discouraging -- and dangerous -- return to "business as usual" on the part of the federal government.

The problems are well-known to all of us. The federal government regulates too much. It taxes too much. It starts the year by planning to spend too much, and ends the year by spending even more. That has happened over and over again in the past, and has produced the unacceptably high rates of inflation, unemployment and interest that this President inherited.

Worse yet, those repeated past failures have generated an understandable cynicism, uncertainty and "inflationary expectations" about the government's resolve to control itself, which makes the cycle extraordinarily difficult to break.

The American people knew the situation was serious, and required that some tough decisions would have to be made. That's what the 1980 elections were all about.

President Reagan went right to work to reverse the nation's economic drift. The Economic Recovery Program he outlined in February marked a dramatic turn-around for the economy and the role of government. At his insistence, Congress enacted the largest reductions in federal spending and taxes in U.S. history.

The fiscal package, which is just beginning to take effect, is already proving to be good medicine for the economy.

The Administration has won some major victories in the drive for economic recovery. But this is <u>not</u> the time to sit back and relax or, worse, retreat. The President has charted a course for our government — filed a navigation plan, if you will — but in order to reach our destination, the Administration must still steer the ship.

There have already been some rough economic currents that threaten to carry the President's program off course. Projected federal spending and deficit levels for Fiscal Year 1982 now look like they're going to be higher, by about $16 billion, than was predicted last spring. That's due in part to the Congress' failure to enact some $13 billion in spending reductions the President recommended, and in part because of high interest rates the government must pay on the national debt. The doomsayers predict and expect just another round of spending overruns.

Those projections need not come true. Corrective action can be taken. The people, through their government, can steer the ship back on course. And we've got a President at the helm who is ready, able and willing to do just that.

There is no question as to this Administration's resolve to do whatever is necessary. There is no question as to the strong endorsement that the business community and the public at large have given to the President's program.

The only question in the minds of the public is whether the Congress has the courage of the President's convictions.

The proposals outlined by the President on September 24 will put America back on course. The plan is responsible and ambitious but very "do-able."

It will, by holding this year's deficit in the $42-43 billion range, keep us headed toward a balanced budget for Fiscal Year 1984.

It will, by holding down the deficit, reduce the upward pressure on interest rates created when the federal government borrows money.

It will, by proving that promises can be kept and the deficit can be controlled, renew the public's confidence in our economic future, and reduce the expectations of failure that have kept inflation and interest rates at artificially high levels.

The basic thrusts of the President's program are not new — they are the basic principles of a free society. They are the same guidelines he announced this spring and the platform upon which he was elected. Reduce the federal budget and deficit spending. Limit the federal government to essential functions such as national defense and the "safety net" for the dependent poor. Cut the size of government both in terms of employees and agencies. Eliminate unnecessary federal interference in the marketplace and unleash the forces of competition and free enterprise.

President Reagan has made specific proposals to restore fiscal control.

First, cut discretionary spending by 12 percent across-the-board in most Departments and Agencies. There is still far too much duplication, waste and overhead in most programs, and departments can and will absorb those cutbacks without harming their essential services. The overriding national interest in economic recovery must prevail over particular programs, regardless of how well intentioned they may be.

Even defense spending, crucial as it is, is not beyond the reach of new budgetary restraint. The Defense Department will reduce spending by $2 billion in Fiscal Year 1982, and $13 billion over the next three years. This comes on top of $3.5 billion already cut in the first round. But the resulting spending levels can still carry out the President's commitment to restore America's military strength.

Second, cut the size of government by eliminating some 75,000 non-defense positions, and by scrapping the Departments of Energy and Education. The personnel reduction over a three-year period represents only 6 1/2 % of the non-defense workforce, much of which can be achieved through normal retirements. Those two departments created by the last Administration, will not be missed by the public. Indeed, much of their programs can and should be carried out elsewhere: education by state and local school boards and energy in the marketplace. These management reforms will save money and weed out unproductive federal agencies.

Third, reduce the government's presence in the credit market by cutting back on federal loan guarantees. Loan guarantees don't usually show up in the "spending" column of the budget ledger -- unless the payments aren't made and government has to pick up the tab. But they do create market pressures and show up in the form of higher interest rates for businesses and consumers alike, since government guarantees to a favored few restrict the availability of capital for everyone else.

There's an overriding national interest in seeing lower interest rates and the economic activity that comes with reasonably available capital. The President's proposal to reduce loan guarantees by $20 billion, when combined with reduced deficit financing and steady monetary policy, will go a long way toward bringing interest rates back to reasonable levels.

Fourth, reduce spending, by reforming welfare and other so-called "entitlement" programs. This has been perhaps the fastest growing area of the federal budget in recent years — 2300 percent since 1955 — and its growth must be curbed to control overall spending. The Administration will, of course, protect benefits for the dependent poor to whom such assistance means survival. The President has compassion, both for the needy recipient and for the taxpayer, and will treat both fairly. But, fraud and abuse in programs such as food stamps - estimated to be as high as $1 billion per year - will not be tolerated, and excessive benefits for those not truly in need should not be allowed. The effort will take time, and requires Congress to make legislative changes in programs, but it simply must be done.

Fifth, increase government receipts, by stepping up tax and debt collection efforts, and by imposing user charges on certain government services. The recent tax act created strong incentives for individuals and businesses to invest more, and it provided much-needed pressure for Congress to spend less. The tax reductions were long overdue, and this Administration has no intention of retreating on the tax increase. Most of the discipline should and will come on the spending side of the budget.

But a few changes can be made on the revenue side. Some minor changes can be made in the tax code to eliminate incentives that have become obsolete, and to improve collection procedures to reduce tax evasion. In addition, more can be done to collect the $25 billion in delinquent debts owed to the government.

The President has also proposed user charges to recover a greater share of the $3.3 billion the government spends to provide special services for air and water transportation. The additional $1 billion the President recommended for Fiscal Year 1982 would be paid by commercial air and shipping interests, and the owners of yachts and private planes — groups that can afford to pay for the special services they receive. These revenue adjustments will help narrow the deficit, and make sure that everyone pays his fair share.

These proposals will keep the American economy on the road to recovery.

Another key component of the President's Economic Recovery Plan is maintaining a stable rate of growth in the money supply. Only that rate of monetary growth which is consistent with the long-term growth potential of the economy should be allowed in the long run. Too often monetary growth policy has been changed as a result of short-term considerations and this has produced the roller-coaster effect so detrimental to financial markets. Recently, the rate of growth for the most familiar measure of the money supply has fallen below target levels. The Fed is being urged to maintain a steady and moderate growth rate. Like the rest of the President's economic program, this is a continuation of the commitment to stable growth policy.

Of course, the most visible barrier to vigorous economic growth is the current high level of interest rates. It is no wonder that investors are wary of policymakers in Washington. Too often in the past, discipline has lapsed and both budget deficits and money growth targets were completely missed. Perhaps this is why Wall Street is a bit skeptical. But the President will not retreat from his economic agenda for the nation; and when Congress finally recognizes the urgency of the Administration's fiscal and monetary policies, Wall Street will respond with enthusiasm.

These steps outlined by the President blend together very well into a coherent economic program for Fiscal Year 1982 and beyond. It's the same consistent program that President Reagan advocated on the campaign trail, in his economic messages this past winter and spring, and in his deliberations with Congress.

And that program serves a higher and nobler cause -- the need to revitalize the economy and spur economic growth in the 80's. Economic growth, making America more productive, is the bottom line. This Administration does not share the belief of those who would impose arbitrary limits on growth, and try to allocate scarcity. Real growth is by far the best social welfare program imaginable. Only through growth will this nation produce the jobs and economic wealth to help lift poor and disadvantaged citizens out of poverty. This can be done only through growth in the dynamic private sector, not an increasingly bureaucratic public sector.

Growth of this private sector, rather than continued expansion of the government bureaucracy, is the key. That thesis has been tested and proven successful.

The 60's were a decade of tax cuts and economic growth. During that decade more than half of all American families living below the poverty line rose above it.

The 70's, on the other hand, were a decade of bureaucratic growth and a sluggish economy. Virtually no progress was made in getting Americans out of poverty.

The 70's produced higher inflation, skyrocketing interest rates, a tidal wave of government spending and debt, and a staggering array of new agencies and regulations that have stifled the American spirit.

The President's program will work. It will balance the budget in 1984. It will reduce government's share of the gross national product from 23% today to a more reasonable 19% by 1984. It will provide added flexibility and freedom for private businesses, for state and local government, and for individual citizens. And, most importantly, it will create 13 million new jobs by 1986 — real jobs with a future, in the private sector.

The "New Beginning" that President Reagan promised us last year is already underway. Our spirits have been lifted, and we have regained our hopes for the future. The President had the courage to propose a bold new economic program this spring, and the Congress, to its credit, had the bi-partisan courage to enact much of it this summer. The benefits of that first round of spending reductions and tax cuts, combined with new block grants, regulatory reforms and other Administration initiatives, are already being felt.

That new beginning must continue. The President has once again demonstrated he has the courage to continue implementing his blueprint for economic recovery. Once again, he needs the support of Congress. Once again, he needs the support of the American people. Once again, there's healthy public debate on the proper course for our government to follow. And I am confident that, once again, the people and the Congress will respond positively, to support the President, so we can get America moving again.