BRITISH EMBASSY,
WASHINGTON, D.C. 20008
TELEPHONE: (202) 462-1340

FROM THE AMBASSADOR

16 April 1981

The Rt Hon The Lord Carrington KCMG MC
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
London SW1

My Lord,

THE REAGAN ADMINISTRATION'S ECONOMIC POLICY - AN INITIAL ASSESSMENT

Introduction

1. Since he took office on 20 January, President Reagan and his close associates have given overriding priority to formulating and presenting their economic prescription for the United States. The programme which the President announced to the Congress on 18 February, and presented in detail on 10 March, reflects the economic philosophy which he expounded during the election campaign last autumn. This was that the economic troubles of the United States - and indeed of the western world - stem from too much government, whether this takes the form of extravagant social programmes, high taxation stifling initiative, or over-regulation of industry and commerce. The purpose of this despatch, primarily the work of Mr H G Walsh, Economic Counsellor in the Embassy, is to describe the main elements of the Administration's programme for the domestic economy and the thinking which underlies it; and to offer some preliminary thoughts about its prospects of approval by the Congress, and of achieving the goals which the Administration have set.

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2. The Administration has not yet focussed its attention on international economic policy to the same extent as on domestic policy. On relations with the developing countries, an indication of their approach is contained in the paper they have circulated on a framework for cooperation between the industrial and developing countries in preparation for the Ottawa Summit. This indicates that the Administration's approach will be tough and market-oriented, with bilateral aid and other assistance related to political and security objectives. An increased role will be sought for the private sectors in achieving flows of resources to promote development. Multilateral aid, including that given through the World Bank, will be given a low priority and will be subject to a thorough scrutiny of its effectiveness. Outside the aid field, the alignment of interest rates on export credit with market rates will probably be pursued even more vigorously than under the Carter Administration, since the Administration propose to cut the funding of the Ex-Im Bank. Their economic philosophy makes it unlikely that they will be amenable to an international approach to synchronise reductions in interest rates and their approach to the dollar exchange rate will be to allow it to find its market equilibrium. They will be disposed to foster free trade and to accept its domestic consequences provided that it is also fair.

The Domestic Economy

3. It is clear from the election result that the general theme of President Reagan's economic strategy struck a responsive chord throughout the United States. The general principle that the Federal Government's role in economic life should be reduced is popular even in areas such as the northern industrial states which stand to lose most from reductions in Federal expenditure. The proposed change of basic philosophy can perhaps best be gauged from the following extracts from the President's address to the Congress on 18 February and his

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Inaugural Address on 20 January:

> "The taxing power of government must be used to provide revenues for legitimate government purposes. It must not be used to regulate the economy or bring about social change. We have tried that and surely we must be able to see it does not work".

> "In this present crisis, government is not the solution to our problem; government is the problem."

4. The President's statements refer to widespread discontent with a welfare system that reflects the values of the eastern liberal establishment and tends to provide little incentive for those on welfare to return to or take up work, with interference at local level such as busing programmes for school children to meet social rather than educational objectives, with a food stamps programme believed to be subject to widespread abuse, with artificially created public sector jobs to "make work", and with a welfare bureaucracy which has a vested interest in providing services at a higher level than the "safety net" ensuring minimum standards for the poor. The Administration point out that, in order to finance increased public expenditure, the level of Federal income tax has been allowed to rise surreptitiously through the effect of inflation in causing so-called "bracket creep" (there is no provision for automatic indexation of the tax brackets in US tax legislation). The extent of this "bracket creep" is illustrated by the fact that in 1965 only 6% of US taxpayers faced marginal income tax rates of 25% or more. This proportion has now risen to about 30%. The combined effects of low productivity growth, high inflation and increased taxation have meant that the real take-home pay of the typical US production worker is now no higher than it was in the early 1960s. (Family income has

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risen mainly because of the increased participation of women and other members of households in the labour force.)

5. President Reagan does not claim that the US has reached a higher degree of collectivism and regulation in economic affairs than has been reached in other Western countries. He is appealing to the general feeling that for too long America had been moving in the wrong <u>direction</u>: away from the fundamental individual economic freedoms of the past and towards regulation and an emphasis on consumption and safe investments which have left little room for creativity and innovation. Part of the hope that he holds out for a reversal of this trend is that economic policies in the United States have not been inimical to wealth creation for as long as in some other countries such as the UK, and that the damage is not irreversible provided that some of the trends in American economic and social life are themselves reversed. He now proposes to revert to increased reliance on the market mechanism to achieve the main economic goals.

The Programme for National Economic Recovery

6. To achieve his objectives and deal with the problems of the American economy, President Reagan has proposed a four-part economic programme consisting of:

- (i) spending cuts and other measures to reduce the budget deficit;
- (ii) reductions in personal tax rates over three years and in business taxes;
- (iii) reductions in the burden and intrusiveness of federal regulations; and
- (iv) a new commitment to a stable monetary policy.

This programme is described in more detail in the Appendix.

/The Economic Scenario

The Economic Scenario

7. The Administration have set out an economic scenario for the American economy for the period up to 1986, which they aim to achieve be securing the implementation of their programme. The main targets are for steady annual real growth of around 4% by 1986, combined with a reduction in inflation to 4% and unemployment to 5½%. For 1982 the scenario assumes real GNP growth of 4.2%, a rise in consumer prices of 8.3% and unemployment at 7.2%. The average interest rate on a 91-day Treasury bill is forecast to decline from about 11% on average in 1981 to 9% in 1982 and gradually thereafter to 6% in 1986.

The Main Questions

8. Two main questions arise at this stage. First, what effects the proposals would have, if fully implemented; and second, what are the prospects of the tax and expenditure cuts being enacted by the Congress?

The effects of the programme

9. On the first question, the Administration have said that they do not regard as relevant assessments of their programme based on whether it adds to, or subtracts from, aggregate demand. The expansionary impact of their programme on the American economy is supposed to come not from extra demand but from the removal of artificial restraints imposed by the Government. In formulating their scenario they have relied on four main macro-economic effects:

(i) a recovery of savings from their present historically low levels on the assumption that at least part of the money saved from public expenditure reductions, and passed on in tax reductions, will not be diverted to consumption;

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(ii) an increase in the supply of labour brought about by the effect of the income tax reductions in increasing the net returns to extra work effort;

(iii) a stimulation of investment brought about by the reductions in business and capital gains taxation and the elimination of over-regulation;

(iv) a reduction in inflation brought about by the reduction in the rate of growth of the money supply (which is assumed to have no, or few, adverse effects on real output).

The Administration are relying on the multiplier effects of confidence. Their forecasts of declining prices and interest rates are put forward with the intention that economic decision-takers should adjust their plans accordingly, so that pay demands will be moderated and financial markets stabilised.

10. President Reagan is fortunate to be taking office at a time when there is no immediate shortage of energy supplies, or the imminent prospect of large real increase in the price of oil. There is still room however for scepticism about his economic scenario. In particular, the assumption that restraining the growth of the moeny supply will reduce inflation but not output is clearly at the extreme of a range of possible outcomes. If there is strong growth in 1982 as the Administration predict, there is at least a risk that it will be choked off by monetary restraint, since the independent Federal Reserve Board's policy of reducing the rate of growth of the money supply, to which Chairman Volcker is firmly committed, could well cause a recurrence of the high interest rates of much of 1980 (with possible recurring effects on the dollar exchange rate against other major currencies). Most

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outside forecasts for real GNP are in the range $2\frac{3}{4}$ - $3\frac{3}{4}$ for 1982 (following $1\frac{1}{2}$ - $2\frac{1}{4}$ for 1981); those at the lower end typically are based on the assumption that interest rates will be higher than predicted by the Administration. Even ignoring inconsistency with monetary policy, most commentators think that it will be very difficult to achieve a deceleration of the rise in consumer prices to 8.3% combined with 4.2% real growth in 1982. The Administration's forecasts do not seem to have taken adequate account of rising costs such as indexed pay agreements, and most outside price forecasts are higher. But the general prospect is for at least some resumption of growth and decline in inflation in 1982, which should be helpful to the prospects for recovery in other industrialised countries.

11. Setting aside the Administration's detailed forecasts, will the proposals produce a much more dynamic American economy without unpleasant side effects? Again, there is room for some scepticism, especially in the short run. Even under the Administration's assumption of greatly reduced inflation, most of the tax cuts will be offset because there will be no indexation of tax brackets during the period of their implementation. Because some of the public expenditure cuts could place an increased burden on the States if services are to be maintained, some of the Federal tax reductions might be offset by local tax increases, reducing their incentive effect. To the extent that extra incentives are created by the programme, the effects on the economy could well be felt in 1983 and beyond, since it may take some time for work habits to adjust and for extra output to be generated from additional saving and investment.

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12. The specific prescriptions of tax reductions aimed at providing incentives, public expenditure cuts aimed at a balanced budget through reduced waste and inefficiency, a reduction of the federal regulatory burden and reducing the growth of the money supply to counter inflation are not new. President Carter had already embarked on economic policies, or had made proposals, not dissimilar to some of Reagan's. President Reagan's main departure from the policies of recent Presidents seems to be in the distributional impact of his programme. If it is put fully into operation, better-off Americans and the already expanding regions of the sun belt will almost certainly benefit. California, and other States with a large concentration of defence industries, would seem especially likely to be net gainers. The less well-off and the northern cities, on the other hand, seem likely to be the main losers from the programme. With the general level of unemployment now about 7%, and that for black male youths above 30%, its main effects could well turn out to be social rather than economic. This is particularly likely to be true if rapid economic growth is not in fact achieved as soon as the Administration intend, and if a high rate of unemployment (especially amongst blacks) persists.

13. Since the main purpose of the programme is to influence the environment within which the free market operates, its effect on investment and productivity will come through mainly in the medium to long term. It will not provide much immediate help to the traditional industries at present in difficulty, such as cars and steel. The car industry particularly, whose present decline has put half a million people out of work, has just suffered its largest losses in history, and Japanese imports have reached almost 25% of the US market. The Administration will face continued demands from such industries for help of one kind or another to enable

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them to recover their stride and meet the technological challenge from outside - a challenge no longer confined to the traditional industries. Problem areas like this will chafe uncomfortably against the Administration's fundamental free market philosophy.

Prospects in the Congress

14. The annual Congressional budget process normally breeds temporary alliances of Congressmen across party boundaries to achieve specific objectives in the expenditure and tax fields. This means that, although the President has the formal power to reject Congressional legislation, the package of expenditure and tax measures eventually enacted is usually a compromise and may bear little relationship to what was originally proposed by the Administration. To avoid this, President Reagan has made a major effort to speak personally to as many Congressmen as possible about the need to maintain the integrity of his economic programme. He has made the programme's promotion the overriding priority of his Presidency to date, assiduously deploying those skills as a communicator which are reckoned to be his principal asset. He is also in a position to exert pressure, since Republican Congressmen will be looking for his support in the 1982 elections.

15. The President's efforts have no doubt made some favourable impact, but do not now look like being decisive. The Republicans have a majority in the Senate and therefore a majority on all Senate committees. But despite this even in the Senate the programme has now, after initial smooth progress, run into difficulties. The Senate Budget Committee has so far refused to forward a draft resolution embodying the complete programme including the tax proposals to the Senate as a whole. Three Republicans on the Committee joined the Democrats to vote

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against this because they were reluctant to agree to tax reductions for individuals extending over three years while a large part of the scheduled public expenditure reductions in the second and third years remain to be identified.

16. The House of Representatives is expected to vote on a budget resolution in late April or early May which, as at present drafted, is inconsistent with the Administration's proposals in a number of respects. Although it would achieve the total amount of public expenditure savings desired by the Administration, it would also restore some outlays on social programmes which the Administration wishes to cut and compensate by holding back defence spending. More importantly, it embodies a proposal for a one-year tax cut for individuals which is smaller (and less regressive) than the Administration's. President Reagan has said that the Administration sees no need for a compromise at the present stage.

17. What is likely to be the final outcome? While the Senate might eventually agree to the multi-year tax cut for individuals proposed by the Administration if conservative Senators were sufficiently certain that public expenditure cuts beyond FY82 would actually be achieved, such an outcome seems unlikely in the House. The Administration will therefore probably have to compromise on their tax proposals if their programme is to be in place before FY82, which begins in October 1981. This might be done by their agreeing to only a one-year cut for individuals in the first instance. Their proposals for cuts in business taxes should however be enacted broadly as originally outlined. On the expenditure side, most guesses by Congressmen of the proportion of the Administration's budget cuts that will be enacted in FY82 place the figure at

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about three-quarters. Substitute cuts will probably be hard to find in FY82, and the identification of sufficient cuts to meet expenditure targets for later years may require radical proposals in the medical, social security and welfare fields. The Administration recognise that they will need to take a much more searching look at these programmes than they could do in the few weeks after the inauguration. Now that targets have been published, any failure to enact expenditure cuts of the size proposed would clearly not augur well for inflation or interest rates, and it would have a harmful effect on confidence.

Personalities

18. Unquestionably, the key figure below the President so far has been Mr David Stockman, Director of Management and Budget. Without his drive and detailed knowledge of public expenditure programmes (acquired during a decade as a Congressional aide and Congressman) the Reagan programme could not have been put together in such a short space of time, and vital impetus would have been lost by the time it was assembled.

19. The Treasury team, however, have not made such a good initial impression. Secretary Regan has not yet managed to imprint his views on economic policy, and is hampered because two of his Under-Secretaries (Mr Beryl Sprinkel and Mr Norman Ture) firmly hold disparate views. Mr Sprinkel believes that the economy is best controlled through control of the money supply, while Mr Ture places greater emphasis on reducing the tax burden on individuals and on minimising the role of the Federal Government. Chairman Volcker of the Federal Reserve Board (who has responsibility for monetary policy under the Federal Reserve Act) is just as committed to a

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reduction in the rate of monetary growth as a way of getting down inflation as the Administration, but beneath the surface there are signs of disagreement between him and Mr Sprinkel both on monetary techniques and on policy. Mr Sprinkel, an advocate of monetary base control, suspects Mr Volcker of paying too much regard to the level of interest rates, and of an excessive tolerance to short-term fluctuations in monetary growth. Mr Weidenbaum, the Chairman of the Council of Economic Advisers, appears to have acted as an effective binding agent despite having been appointed late. In the discussions leading to publication of the Administration's scenario, it was reportedly he who played a key role in reaching a compromise.

Provisional Conclusions

20. (i) President Reagan has widespread public support for the direction which he now proposes for the domestic economy, and for the general thrust of his programme for national economic recovery.

(ii) Even if implemented in full, the programme may not produce the 4.2% growth in GNP and inflation rate of 8.3% in 1982 predicted in the Administration's economic scenario. There should however be some real growth in 1981 and 1982, together with a gradual decline in the rate of inflation. Success will depend on confidence which in turn will be geared to the complicated cog-wheels of Congress, as well as to the hard-headed judgements of the business and financial community.

(iii) According to the normal timetable for US budgetary procedure, that part of the Reagan programme which requires legislation to give it effect should have passed through all the necessary Congressional stages by next October. But present difficulties in Congress indicate that, if it is to be enacted on schedule, there will have to be some modification of the proposal for a full 30% reduction in personal tax rates over three years. The President is however likely to get the bulk of his expenditure cuts through Congress, and also the proposed reduction in taxes on businesses.

(iv) There could well be social and regional repercussions from the distributional effects of the Administration's policies if rapid economic growth is not achieved so that the present high level of unemployment (especially for blacks) persists, and if adequate measures are not taken to assist or protect industries facing special difficulties.

21. I am sending copies of this despatch to HM Representatives at Paris, Bonn, Rome, The Hague, Brussels, Luxembourg, Copenhagen, Dublin, Athens, UKREP Brussels, UKDEL OECD, UKDEL NATO, UKMIS New York, UKMIS Geneva, Tokyo, Ottawa, Canberra and Mexico City, as well as to HM Consuls-General in the United States.

I have the honour to be,
My Lord,
Your obedient Servant,

Nicholas Henderson

APPENDIX

1. The Administration's proposals listed in paragraph 7 are described in more detail below.

(i) <u>Reducing the Budget deficit</u>

2. The aim is to balance the budget by the fiscal year 1984 (October 1983 - September 1984). Massive cuts are proposed in the previous Administration's plans for public expenditure. These cuts rise from $48.6 billion in FY82 to $201.7 billion in FY86. The savings in FY82 have all been identified, but in the years FY83-86 a further $30-$45 billion per year in savings are required that have not yet even been ascribed to individual programmes. The intention is to increase defence expenditure (compared with existing plans) by $6.2 billion in 1982 to $63.1 billion in 1986, and to maintain a "safety net" of social benefits for the poorest. To allow budgetary provision for safeguarded "safety net" and defence expenditure to increase, all other expenditure (including the unidentified savings) is proposed to be reduced by about one-quarter (in money terms) as early as 1984. The average annual growth in total Federal spending has been about 16% (in money terms) in recent years, and it is proposed to reduce this to about 5.5%. Even on the Administration's optimistic assumptions about inflation, this means an overall reduction in volume terms, and a much bigger volume reduction in programmes other than defence and those in the "safety net".

3. The budget cuts proposed extend over a wide area, including expenditure on social programmes outside the "safety net"; on public employment programmes; on Federal aid to public transport; on energy "R and D"; on assistance for workers

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especially affected by imports; on natural resources and the environment; and on support for the arts. It is also proposed to consolidate nearly 100 grant programmes to the States, under which Federal aid is disbursed provided State expenditure falls into certain approved "categories", into a few multi-purpose block grants for State support of education, health and social services. The aim is to allow the States more flexibility to adopt their own approaches in providing these services. Federal subsidies for synthetic fuels, the Ex-Im Bank, the dairy industry and capital projects are also to be sharply cut back. Increased user fees are to be imposed on airway system users, barge operators and commercial and recreational vessels. Reductions are also proposed in off-budget outlays, rising from $4.7 billion in 1982 to $11.6 billion in 1986. These include reductions in loans for rural electrification and home purchase, for low-rent public housing and for students in higher education.

4. A freeze has been placed on hiring to fill Federal Government posts, and restrictions have been imposed on expenditure on office furniture, consultancy fees and travel by Federal employees. Employment in non-defence agencies is proposed to be 63,000 fewer than existing policies would imply by 1982 (but 20,000 more in the Department of Defense).

(ii) <u>Reductions in taxation</u>

5. The proposals for tax reductions for businesses are that, for the purpose of calculating taxes, company assets should be written off within certain specified periods instead of (as at present) being fairly closely related to the actual useful life of the equipment concerned. The main periods would be 3 years for vehicles and machinery and equipment used for "R and D", 5 years for most common factory equipment and 10 years for factory buildings. It is proposed that these arrangements

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should be retrospectively made effective from 31 December 1980. It is also proposed to reduce personal income tax rates by one-tenth each year for 3 years, effective from 1 July 1981, 1 July 1982 and 1 July 1983. The cumulative effect of this would be a 5% reduction in the income tax rates in the calendar year 1981, a 15% reduction in 1982, a 25% reduction in 1983 and a 30% reduction in 1984. The highest marginal tax rate, both for earned and unearned income, would be 50% after the 1983 change. The top rate of capital gains tax would be reduced from 28% to 20% by 1984. No change is at present proposed in the brackets to which these rates apply, which are fixed in money terms and <u>not</u> automatically indexed to inflation. Taking this into account, Federal revenues are expected to rise by 50% by 1986.

6. The objectives of the tax reductions for individuals are to encourage saving and to create more output by encouraging work at the expense of leisure. They are not designed to boost demand. They will especially benefit high earners and, because of this, it is hoped that a large part of the reductions will go into savings while the additional income created by their incentive effect will generate extra tax revenue to at least partially finance the reductions in tax rates.

(iii) <u>Reducing the burden of Federal regulations</u>

7. The third element in the programme is a reduction in the burden and intrusiveness of government regulations. Complying with existing regulations is estimated to cost the private sector approximately $100 billion a year. Their administration costs a further $20 billion, so that at present 4.5% of GNP is taken up in meeting Federal regulations. The reforms will not however (at least at first) reduce this enormous burden

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significantly. The main intention is to delay or cancel new regulations which would, if implemented, impose a further cost. A temporary freeze has been placed on all new regulations to permit them to be reviewed before they are implemented. Federal agencies will no longer be able to promulgate new regulations without satisfying a task force led by Vice-President Bush.

(iv) Monetary Policy

8. The fourth element in the Administration's programme is the commitment to a firm and stable monetary policy. This was included after consultation with the independent Federal Reserve Board, which has not however expressed explicit approval of the published version. The Administration's objective is to reduce the rate of growth of money and credit by 1986 to half that in 1980, but without any annual targets for that period in between. While the absence of a published path for the main monetary aggregates makes the policy difficult to assess, it seems clear that the Administration would prefer a steadier growth than was achieved by the Federal Reserve Board in 1980.

(4)

Mr Walters

Prime Minister

SUMMARY

THE REAGAN ADMINISTRATION'S ECONOMIC POLICY - AN INITIAL ASSESSMENT

1. Since he took office on 20 January, President Reagan has given overriding priority to his economic programme. His Administration has not yet focussed on international economic policy to the same extent (paragraphs 1 and 2).

2. He aims to reduce the Federal Government's interference in the economic life of the nation, arguing that government is not the solution to the nation's problems but that it is the problem. The election result shows that this theme struck a responsive chord throughout the United States (paragraphs 3-5).

3. He has proposed a four-part economic programme: spending cuts; reductions in personal tax rates and in business taxes; reductions in Federal regulations; and a commitment to a stable monetary policy. The Administration have set out an optimistic scenario for the US economy which they aim to achieve with their programme (paragraphs 6 and 7).

4. The Administration claim that the main effects of their programme will be to raise savings; to increase work effort; to stimulate investment and to reduce inflation. However, they recognise the risk that strong growth could be choked off by monetary restraint imposed by the independent Federal Reserve Board. There is also some room for doubt that the claimed effects will materialise, at least in the short run. The programme is unlikely to provide much immediate help to the traditional industries at present in difficulty, such as cars and steel (paragraphs 8-13).

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5. The President has effectively deployed his skills as a communicator in selling his economic programme, but these do not now look like being decisive in Congress. Many are concerned that the programme will not lead to a balanced budget by fiscal year 1984 and so are reluctant to grant the full 30% tax cut over 3 years. But, although Democrats are unhappy about the impact of the programme on the less well-off, the President may still get the bulk of his expenditure cuts approved (paragraphs 14-17).

6. The economic team under the President has now yet entirely settled down but the key figure below the President so far has been Mr David Stockman, Director of Management and Budget (paragraphs 18-19).

7. Some provisional conclusions are drawn in paragraph 20 of this despatch.

The Stockman Express

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HOW A 34-YEAR-OLD FORMER ANTIWAR ACTIVIST AND DIVINITY STUDENT HIGHBALLED HIS WAY TO COMMAND OF THE FEDERAL BUDGET

BY WALTER SHAPIRO

Eight days before the inauguration, Ronald Reagan's cabinet hosted a black-tie dinner at the F Street Club to honor the transition teams. Donald Regan, the new treasury secretary, was sick, but he sent a toast to be read in his name.

According to a participant, Regan's dinner toast read like this: "No one has made greater use of the transition teams than I have. Only by totally working my whole transition team 15 hours a day could I keep Dave Stockman under control."

The secretary of the treasury had reason to be worried about David A. Stockman, the new director of the Office of Management and Budget. At age 34, after two terms as a Michigan congressman, Stockman is the youngest person to hold Cabinet rank in more than 150 years. He comes to power with a controversial agenda to transform American economic policy and a young man's faith in the potency of his own ideas.

For starters, Stockman wants to mount a frontal assault on the federal budget. He isn't cowed by the congressional appropriations process. Nor is he frightened by the special interests nor liberal bleeding-hearts who defend their favorite sections of the budget with the ferocity of junkyard dogs.

The OMB post may be his battle station, but budget-cutting is only part of his ambitious strategy.

Stockman, who believes in free market economics, wants to declare holy war on the kind of federal regulations that businessmen curse over their martinis. Unlike the more cautious Regan, he is a zealous advocate in the Reagan cabinet of across-the-board, permanent Kemp-Roth tax cuts.

If tax-cut strategy works, Stockman believes that the energies of America will be unleashed in an orgy of productive frenzy. And, if it fails, Stockman will have to defend the largest budget deficits in American history. Either way, Stockman promises to be at the center of the firestorm that will swirl around Reagan economic policy.

Walter Shapiro is a staff writer with The Washington Post Magazine.

In the early scrimmages among the Reagan team, Stockman has already broken away for long yardage. Alan Greenspan, a key outside adviser to Reagan, said, "Among those going into government, Stockman has the most conceptual input right now. Dave deserves the status that he has achieved. He's done an extrordinary job. He's the brightest guy around."

There are many bright, intensely driven, 34-year-old whiz kids in Washington. But Dave Stockman is different. At a time when many of his contemporaries are bucking for regional sales manager or worrying if they are partnership material, Stockman is trying to impose discipline on an unwieldy $739 billion budget.

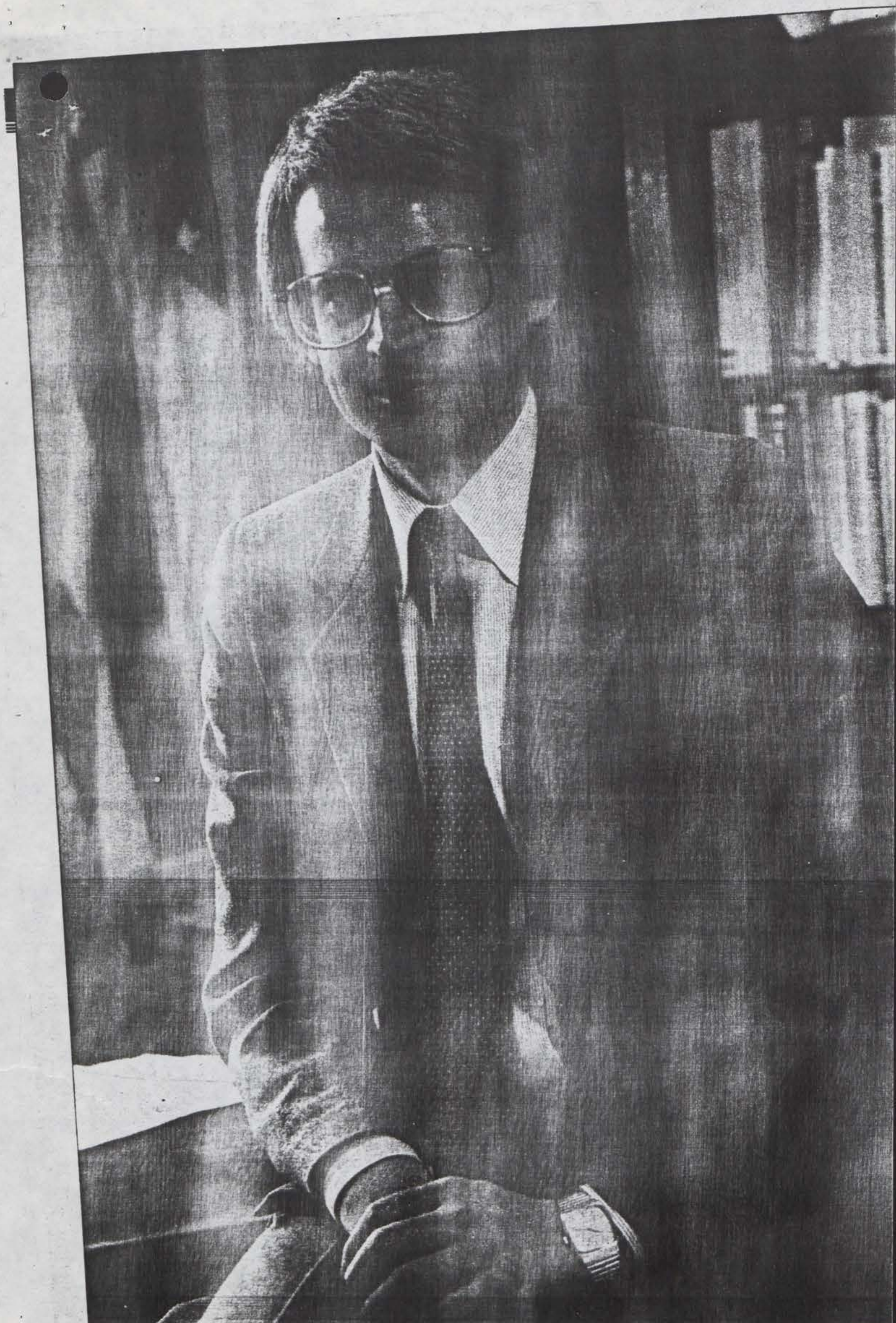
His meteoric rise is a tale of raging ambition. Stockman himself concedes that at times, it makes him "appear to be the most conniving character in history."

The Stockman saga illustrates that, even in an age of falling expectations, America is still a meritocracy, ready to reward bright Midwestern farmboys who work hard, cultivate their betters and keep their eye squarely on the main chance.

It was just 14 years ago that Ronald Reagan, pledging to get tough with campus demonstrators, was sworn in as governor of California. That same year, 1967, Stockman was an antiwar activist on the sprawling East Lansing campus of Michigan State University. In the spring, he came to Washington for an antiwar rally. That summer, between his junior and senior years in college, Stockman worked as the only full-time organizer in the Lansing area for Vietnam Summer, arguing that Vietnam was an internal civil war.

Today, Stockman remembers Vietnam Summer as "pretty much of a bust." But he also fondly recalls 1967 as the the first summer that he didn't have to return to his family's 150-acre fruit farm outside of St. Joseph, Mich., "to pick berries and haul tomatoes."

Stockman was reluctant to discuss whether he agrees with Ronald Reagan that Vietnam was "a noble cause." But the OMB director gave a revealing answer when asked what stayed with him from that period as an antiwar crusader: "I suppose the same curiosity. It was more intellectual than anything



else. The only thing that has changed is my view of the world. I'm still trying to figure out the world, even now."

The first thing you notice about Dave Stockman are the aviator glasses and the thatch of graying hair swept back in a $25 haircut from a unisex barber. His face is generally impassive, but occasionally in conversation a small smirk will play across his features. Whether it's at his Senate confirmation hearing or in his office early on a Saturday morning, Stockman wears the same conservative uniform—a dark suit from Britches, a white shirt and a sincere red tie.

Much of the surface polish is the work of Jennifer Blei, his 26-year-old girlfriend. She is one of the top computer salespeople for IBM. Two years ago, at the age of 32, Stockman did not own a pair of jeans. "I got him to buy a pair," Blei said, "but they shrank in the first washing so they ended above his ankles. But he kept wearing them. They weren't really a pair of jeans, they were more like a long pair of shorts."

Outside of his work, Stockman's life is about as riveting as the opening pages of Proust's *Remembrance of Things Past*. He and Jennifer Blei occasionally play chess. They go out to dinner at homes of friends like Rep. Jack Kemp (R-N.Y.) and Richard Straus, editor of a newsletter on Middle East affairs. But as Blei put it, "If this is going to be a personal piece about Dave Stockman, it will be a really short article."

Small towns in the Midwest breed high achievers. More top-ranking corporate executives are born there than anywhere else. The harsh farm life and the lack of other diversions instill the work ethic. The flat, unchanging landscape inspires among the brightest a desperate urge to escape.

This environment molded Dave Stockman. He grew up on a southwestern Michigan farm that has been in his mother's family since the 1890s. He even went to a one-room school.

The living room of the family farmhouse looks like it was lifted from an old Saturday Evening Post cover, complete with a couch covered in chintz, simulated wood-grain paneling, and a recliner for Stockman's father, Al.

His mother, Carol, said that Dave, the oldest of five, "is the least emotional of the children." That comment triggered a reprise of all the old family arguments that Al Stockman, too, isn't emotional. The OMB director's father finally sat up in his recliner and said, "It's just that I don't let it show." Carol Stockman had the last word: "But you can't keep it all inside you; you'll get an ulcer."

While Dave was at Michigan State, where he originally went to study agriculture, the Stockman family was the scene of many heated debates over Vietnam. Al Stockman, a strong supporter of the war, remembers that "I felt pretty lonely at times."

Fourteen years later, with his son in the Reagan cabinet, Al Stockman finally feels vindicated. "The things Dave is preaching now," Stockman said, "were the things that I was saying back in the days when I was so out of it. College professors always know more about things than the old man at home."

There are college professors and, then, there are Harvard professors. The Stockman saga demonstrates the opportunities that can fall into your bookbag in Harvard Yard.

At Michigan State, one of Stockman's principal interests was religious philosophy. His road to the antiwar movement began at the activist Edgewood United Church of Christ in Lansing, where he also taught Sunday school.

In 1968, Stockman accepted a fellowship to Harvard Divinity School—though he had no intention of entering the clergy. Stockman attributes this decision to his "fascination" with the writings of theologian Reinhold Niebuhr. "I was trying to find a way intellectually out of the radical thicket I was in," Stockman said. "Niebuhr was sort of a bridge back to a more conventional view of the world."

Divinity school conveniently brought with it a 4-D draft

MORRISON SAID HE'D 'BE WILLING TO SURMISE' THAT STOCKMAN KNEW DIVINITY SCHOOL WOULD 'KEEP HIM OUT OF THE DISTASTEFUL SPECTACLE THAT WAS VIETNAM.'

deferment. Stockman denies that he was a draft dodger. But some who knew him well during this period have their suspicions.

Truman Morrison, Stockman's minister in college, wrote one of his recommendations to Harvard. Morrison said he'd "be willing to surmise" that Stockman knew divinity school would "keep him out of the distasteful spectacle that was Vietnam."

Morrison was one of many interviewed for this article who commented on Stockman's self-absorption: "David was always thinking about David a great deal of the time. He is very narcissistic. David has always been very intent on his own personal advancement."

Nothing that Stockman did before or since was more calculated than his campaign to win Sen. Daniel Patrick Moynihan (D-N.Y.) as his mentor. Moynihan was then commuting from Harvard to his job in the Nixon White House.

At Harvard, Stockman recognized the upward mobility of the babysitter. He plotted for months to get a job as the live-in au pair student for the Moynihan family. Before his job interview, the methodical Stockman read all of Moynihan's published writings.

Stockman tended bar, carried groceries, emptied the garbage and looked after the three Moynihan children. The year left an imprint on many of his attitudes toward the federal budget.

Moynihan—along with Harvard professors James Q. Wilson and Nathan Glazer, who also influenced Stockman—were in the forefront of a group of Great Society liberals rethinking the effects of the social programs they had shaped during the Johnson years. Their novel notion was to look hard at the results of social programs instead of merely praising their goals.

Moynihan recalls that it would have been easy for Stockman to become another Harvard radical of the era. "There was something in him that said that this is not as interesting, or if you will, as promising a way to spend your life," Moynihan said. "He chose to be a nonconformist."

Others at Harvard pursued nonconformity by trashing campus buildings; Stockman became a liberal Republican.

It was a shrewd move. In those days, prominent Democrats were awash in Ivy League resumés. Meanwhile, the Republican Party was a geriatric enterprise filled with blue-haired old ladies and corpulent Rotarians.

Another helpful mentor, Washington Post associate editor David S. Broder, brought Stockman together with Rep. John Anderson (R-Ill.), the soul of moderate Republicanism.

Broder was teaching a course at Harvard and Stockman was one of his brightest students. Anderson, newly elected chairman of the House Republican Conference, needed another staffer. Broder mentioned Stockman; Moynihan took Anderson aside after a White House meeting to sing the praises of his young protegé.

Stockman borrowed $50 from his mother to fly to Washington for the interview. Anderson hired him on the spot, and the dream of a divinity degree died forever.

Eighteen months later, 25-year-old Dave Stockman became director of the House Republican Conference, with a private office and a personal staff. In three years, Stockman transformed the conference from an intellectual backwater into one of the best research factories on Capitol Hill.

Stockman calls these years "my formative period." During this period, he developed his "rabid" affinity for free-market economics. It was a conversion that was, in part, dictated by political necessity.

Anderson's liberal social views were alienating orthodox

Republicans. Stockman feared for Anderson's leadership position—and his own job. So he began reading reams of material from the American Enterprise Institute and other conservative think tanks. He was searching for free-market issues on which Anderson could appear to be a mainstream Republican.

Anderson and Stockman were extremely close. At various points, the congressman found staff jobs for two Stockman brothers. When Anderson made speeches in southwestern Michigan, he stayed with Stockman's parents. It was the kind of father-son relationship you see occasionally on Capitol Hill. But it was a relationship eventually doomed by the son's rebellion against the liberal views of his surrogate father.

Anderson himself refused to be interviewed about Stockman. But his wife, Keke, remembered Stockman as "a workaholic. I've never seen a young man so obsessed with work."

Stockman blames his rift with Anderson on his decision not to support the congressman's recent presidential ambitions. "That disappointed him a lot," Stockman said. "Understandably so."

Keke Anderson believes the falling-out happened earlier. "John began to sense," she said, choosing her words carefully, "that there was just too much drive and not enough human aspects there."

There comes a time in every successful young man's life when he wants to do something on his own. Most resist the temptation because of mortgage payments or children. A few start their own businesses or law firms. Dave Stockman, 29, ran for Congress in 1976.

It was a bold gamble. Despite an uninspiring record, Republican incumbent congressman Edward Hutchison was fully in tune with the conservatism of Stockman's home district in southwestern Michigan and showed no intention of retiring. Moreover, virtually no one in the district knew Stockman, who hadn't lived at home since 1964.

Stockman also had to bridge a difficult political and social chasm. His grandfather had

'DAVE WAS WEARING HIS HAIR LONG IN THOSE DAYS, SORT OF OF A PRINCE VALIANT HAIRCUT, AND THAT DIDN'T HELP . . . AND HE GAVE VERY LONG ANSWERS TO QUESTIONS.'

been Republican county treasurer for 30 years and his family was prominent among the farmers in the area. However, Stockman came from a different social class than the local gentry, with their big houses on Lake Michigan.

But Stockman had been prepping for a race against the hapless Hutchison for a long time. He had long earnest talks with a local judge, Chester Byrns, who helped introduce him to the first families of the area. Byrns describes Stockman in those days as "not very sophisticated" with "much of the farmboy still in him."

In 1974, Stockman got his mother, who was a spear-carrier in local Republican politics, elected county chairman. She worked with such intensity on her son's campaign that a congressional aide to Stockman later compared her to "Rose Kennedy or maybe Joe Kennedy."

Meanwhile Stockman stole his young campaign manager from the Republican Conference. David Gerson, now 27, has been Stockman's alter ego as he has moved from administrative assistant to an aide at OMB. Together, back in 1975, they put together the first modern campaign in the history of the sleepy congressional district—a $110,000 primary challenge to Hutchison.

During this time, Stockman somehow found time to write his first article, "The Social Porkbarrel," which appeared in early 1975 in The Public Interest, a small neo-conservative magazine.

The article fused Moynihan's skepticism about social programs with Stockman's knowledge of the hidden byways of Capitol Hill. Social programs, the future OMB director argued passionately, had acquired a constituency that used the same porkbarrel politics as the military-industrial complex.

"That article is how I got to Congress," Stockman said with a laugh. Irving Kristol, the editor of The Public Interest, found occasion to praise it effusively in a long commentary in the Wall Street Journal.

Kristol's column caught the eye of the most influential newspaper publisher in the district. The publisher wrote an editorial suggesting that the Hutchinson era had passed — and that the Stockman era was dawning. "That editorial launched our campaign and things just started to build after that," Stockman said.

Judge Byrns recalls a meeting in his home in the fall of 1975 to introduce Stockman to the local corporate elite centered around Whirlpool, the dominant corporation in the area.

"Dave knew that the dozen or so people I had invited could be financially helpful to him," Byrns said. "But they were skeptical. Dave was wearing his hair long in those days, sort of a Prince Valiant haircut, and that didn't help. He was very hesitant because he knew who these people were. Lord, how he had studied them. He had a nervous habit of stroking his mouth as he talked. And he gave very long answers to questions."

But Stockman's intellect and his knowledge of Washington overcame his social awkwardness. "Stockman fascinated those people because he was a walking computer," Byrns said. "He was using facts and figures that these business leaders could look up. And they did, and they were impressed."

On Groundhog Day 1976, Stockman sprang from his hole and formally announced his congressional candidacy. Two days later, Hutchison announced his retirement from Congress.

Humility was not Dave Stockman's strong suit when he arrived in Congress in early 1977.

At the orientation session for new GOP freshmen, everyone introduced himself, usually with a bit of personal biography. When it was Stockman's turn, he got up and said, "My name is Dave Stockman. I have a great deal of experience on Capitol Hill. My staff and I will be glad to help any of you freshmen get adjusted."

"As you can imagine," said one of his colleagues, "Dave's remarks went over like a lead balloon."

But Stockman had too much on his mind to worry about congressional protocol. He wangled a seat on the commerce committee and was in the forefront of the Republican opposition to Carter's energy programs. He became a self-taught expert on health care and helped lead the fight against Carter's hospital cost containment program.

Beginning in 1977, Stockman put together alternative conservative budget proposals. In March 1980, speaking for a group of 60 House members, he proposed $26 billion in cuts. At a House Budget Committee hearing, Stockman said that he personally wanted to cut $34 billion more.

Blessed with a safe district, Stockman could pursue his ideological interests free from much cant and hypocrisy. He voted against farm subsidies in an agricultural district. He was the only member of the Michigan delegation to oppose the Chrysler bailout.

Meanwhile, Stockman kept writing, churning out more than 20 articles on policy issues, particularly energy, regulation and economics. A third of these pieces, which helped solidify Stockman's reputation as a thinking man's conservative, appeared in the pages of The Washington Post.

At his Senate confirmation hearing, after listening to liberal senators read back some of his more controversial sentences, Stockman said ruefully, "If I do manage to get confirmed for this job, I think I'm going to stop writing."

Perhaps Stockman's shrewdest move in Congress was cementing an alliance with Jack Kemp, the former football quarterback turned tax-cut advocate.

Kemp describes their relationship as "Mr. Inside and Mr. Outside." But a more accurate assessment would be that Stockman provided the brains and Kemp provided, if not the brawn, at least, the public stage presence.

Despite Stockman's self-confidence, he acknowledged that there was a gaping hole in his economic thinking when he arrived in Congress. He had strong views on the budget and oppressive federal regulations, but he lacked an overall economic theory—a macroeconomic philosophy in the jargon of the trade.

"I believed in free-market economics," Stockman said, "but that doesn't tell you anything about macroeconomic policy. I needed a macro philosophy and I didn't have one. Except for a knee-jerk Hooverite view that most Republicans had at the time. But I was a little too sophisticated for that. I knew the budget couldn't be balanced every year."

Kemp's gospel, called supply-side economics, contends that the government went wrong by stimulating consumer demand. What it should have been doing, Kemp argued, was encouraging America to increase production. One policy remedy was a massive tax cut, the Kemp-Roth bill, that would set off a new American industrial revolution.

With Kemp directing his reading, Stockman became a true believer. Up to now, Stockman's strength was his skepticism about well-intentioned social welfare programs and the government's tinkering with the free market. But Stockman seized on supply-side economics with the same zeal that young intellectuals once brought to the writings of Herbert Marcuse.

A week after the 1980 election, before Reagan had picked his OMB director, Stockman and Kemp collaborated on a memo that outlined how the new administration could avoid an "economic Dunkirk." The origins of this memo explain how the dynamic duo of Kemp and Stockman worked.

Kemp, not Stockman, had been invited to the first meeting of Reagan's economic advisers in mid-November in Los Angeles. The former quarterback for the Buffalo Bills felt a bit inadequate in this august company: "There would be all these big-name economists—George Schultz, Alan Greenspan, Arthur Burns—and me, Jack Kemp, sitting around a table. I felt a tremendous sense of responsibility."

Continued on page 13

So Kemp turned to Stockman, his junior partner. "Dave," he said, "we've got to decide on the type of approach I'm going to take at that meeting." Stockman wrote most of the memo and Kemp carried the ball in Los Angeles.

There are signs that Kemp is bristling over Stockman's new prominence. David Gerson recalls a recent half-joking phone call from Kemp. "I'm getting tired of Dave Stockman pushing me off the front pages," Kemp said. "The next thing, I'll be seeing him on the cover of a sports magazine with his arm cocked back ready to throw a pass."

Even as a junior congressman, Dave Stockman had a lean and hungry look. He was toying with running for the Senate in 1982 or 1984. Fred Matthews, his chief congressional fund-raiser, wanted to enter him in the Iowa presidential caucuses in 1984. In the fall of 1979, Stockman tried to get Matthews, an optometrist from Dowagiac, Mich., to raise some money for an exploratory presidential campaign for Kemp.

"What's in it for you?" Matthews said he asked Stockman.

"That way I could be director of OMB," Stockman said.

Kemp never ran for president, but Stockman got to be OMB director by impersonating two presidential candidates. Before Reagan's debate with Anderson, the former California governor practiced by debating the 33-year-old two-term congressman.

Stockman had only met Reagan at large formal meetings, but he was an obvious choice to play Anderson, his former mentor. He was so good he was asked to come back for a second performance in late October as the stand-in for Carter.

The reviews were glowing. Reagan, a former actor, knew talent when he saw it. Alan Greenspan was so impressed by Stockman's impersonation of Carter that he said, "If we had the capacity to give something like an Academy Award, Stockman would have gotten it." Sen. Paul Laxalt (R-Nev.), one of Reagan's closest advisors, said the mock debates were "near-indispensable" for Stockman's unanimous selection for the OMB job.

It is said that some of the most disappointed people in life are those who achieve their dreams too early.

The director of OMB, with its far-reaching responsibilities that cut across the entire government, has always been Stockman's dream job.

"Dave has always been in awe of that position," said Jennifer Blei. "It was the place where he could implement all of his ideas. But it's always been almost like a dream to him. I always felt he'd be an OMB director. But not in 1980."

Two flames have lighted Dave Stockman's charmed life as he has moved from antiwar crusader to OMB director. One is his burning ambition and the other is his glowing faith that his ideas can shape political events.

But Stockman's idealism has always been curiously devoid of compassion. He has described the federal budget as "a coast-to-coast soupline." But he lacks the empathy also to see the budget as people to be served, instead of inflated numbers on a page.

Perhaps this lack of compassion is related to the way Stockman has used his obsession with work to keep people at arm's length.

Nothing in Stockman's career has prepared him to compromise his vocal confidence in his own opinions. An intellectual lone wolf could stand out among the Republican minority in the House. But now Dave Stockman is playing on someone else's team.

As OMB director, Stockman will win some battles in the Reagan White House, but he will lose some as well. In victory or defeat, Stockman will have to defend the administration's policies to Congress, the press and the public.

Will he bear defeat gracefully, and defer to others more powerful—but not necessarily more intelligent—than he? It is a problem that worries the Reagan team. According to corridor gossip during transition, Edwin Meese III, Reagan's closest adviser, personally selected the man who will be Stockman's deputy at OMB, Edwin L. Harper.

His mission is the same as Donald Regan's. To keep Dave Stockman under control. ■

cut reductions in these areas would allow Congress to take credit for evenhandedness: it would not be sparing the Joffrey Ballet while cutting back its assistance to food-stamp recipients.

By the end of last week Stockman was considering a number of additional proposals that seemed sure to offend groups that Congress has traditionally deemed sacred. The most controversial plan involved ending the twice-yearly indexation of Federal employee pension benefits, leaving government workers with a single annual cost-of-living increase in their pensions. Similarly, the law-and-order lobby was bound to oppose any proposal to reduce aid to local police. Even the Pentagon did not seem safe from Stockman's surgery. Last week he suggested that through such measures as closing bases and canceling some aircraft purchases, he could hold the increase in military spending for fiscal 1982 to $10 billion over the Carter Administration's budget, rather than the originally estimated $25 billion. "We are asking every part of the political system to act against their short-term interests," says a White House political operative.

'Yea': That request is likely to be ignored unless the Republicans strengthen their newly acquired leadership of the Senate. Last week, for example, it was only with great difficulty that Republican committee chairmen managed to gain support from their own party members for Reagan's request for an increase in the debt ceiling. When Democratic administrations made such requests in the past, Republicans routinely rejected them as "fiscally irresponsible." Last week, with the shoe on the other foot, the Democrats were balking, forcing what one committee chief called "a very difficult and embarrassing decision for so many conservative Republicans." The finally 73-to-18 vote to raise the ceiling counted North Carolina's Jesse Helms in the "yea" column for the first time in his political career.

Helms may be an important litmus in the battle of the budget. As chairman of the Senate Agriculture Committee, he is committed to a drastic reduction in the food-stamp program—and his position on tobacco subsidies is equally clear. "In North Carolina," he told The Washington Post, "tobacco isn't a commodity, it's a religion." But Helms's biggest test will involve the $1 billion-a-year dairy subsidy that encourages high milk prices and artificial surpluses. In the last Congress, only 70 House members were willing to offend the powerful dairy lobby by voting to eliminate the subsidy. Helms's reaction may determine whether a committed conservative can really fight the special interests.

Every member of Congress will feel similar pressures, but Stockman is prepared to offer them a substantial reward for persistence. According to a new set of eco-

Meet David Stockman

The briefing, held on Capitol Hill one afternoon last week, was a Daniel-in-the-lion's-den encounter between the wily Democratic leadership of the House and the Reagan Administration's boy wonder, budget director David Stockman. On the job less than a month, Stockman, 34, made an earnest pitch for sweeping cutbacks in Federal spending—and in the end even the skeptical barons were impressed. "Every time a Cabinet Secretary comes up here, he brings a battery of assistants and refers everything to them," said House Speaker Thomas P. (Tip) O'Neill. "This guy comes in all by himself and ticks them off boom, boom, boom. I've never seen anybody who knows the operation like this kid—he's something else, believe me."

For a neophyte conservative whose reputation rested largely, until recently, on two short terms in the House, Stockman is fairly dazzling political Washington these days. His frail good looks and boyish charm are potent catalysts for celebrity (although he is now avoiding interviews), and his buzz-saw intellect has helped him stage a series of bravura performances before Congress. Republicans are vying for superlatives to describe his brilliance, and even Democrats concede his formidable command of the budget. "I grasp things quickly, but I'm not even in his league," said one awed liberal, Rep. Thomas Downey of New York. During his whirlwind debut, Stockman has parlayed his appointment as director of the Office of Management and Budget into what is arguably the second biggest job in government—quarterbacking the economic policy on which Ronald Reagan has staked his Presidency.

Eclipse: So completely has Stockman taken control that the economic-policy council formulating the grand strategy Reagan will propose next week is called simply the "Stockman committee." Treasury Secretary Donald T. Regan, who was supposed to be the Administration's chief economic spokesman, has been almost totally eclipsed by Stockman—and doesn't even attend most of the policy group's meetings. That leaves Stockman free to pursue his two economic goals: the supply-side belief that big tax cuts are needed fast, and the firm conviction that the budget can be amply cut by going after programs that subsidize the well-to-do. His aides speak constantly of "safety nets" for the poor and of their ability to trim government while remaining "compassionate." "My political theme," Stockman said recently, "is cutting off the undeserving." Yet many of his proposed cuts seem likely to affect low-income families (page 26).

White House aides say the President's faith in a young man he barely knew six months ago stems from Stockman's role in the campaign. Last summer Stockman was drafted to serve as a stand-in for John Anderson (for whom he once worked) while Reagan practiced for his first Presidential debate. Stockman's blowtorch brilliance in their first session left the candidate stunned. One Reagan aide says he was "amazed at how brazen" Stockman was when, podium to podium in the garage at Reagan's rented estate in Virginia, he excoriated Reagan as a tool of the rich,

John Ficara—NEWSWEEK

Stockman: 'Cutting off the undeserving'?

the scourge of the poor, "heartless" and "ignorant."

Fortunately for Reagan, the real debate was more polite. Reagan himself has since joked that "I lost every debate to Dave Stockman," and he recognized, one senior hand says, that the young congressman "wasn't just another yes guy." Stockman was called back to help Reagan warm up for Jimmy Carter in October and by then, insiders say, Reagan sensed that Stockman was just the sort of bright, tough man he wanted to ride herd on the budget.

Stockman began pushing his ideas well before the Inauguration with a white paper, co-signed by Rep. Jack Kemp, entitled "Avoiding a GOP Economic Dunkirk."

His intent was to warn Reagan of the political risks of inflation and to urge an economic blitz in the first 100 days. After his dire view was backed by economist Alan Greenspan, Stockman went to chief of staff Jim Baker to lobby for the job of budgetary axman. Reagan quickly agreed. Stockman had his entire staff in place and the cuts identified before other Cabinet members had time to set their own agendas. His proposed cuts in foreign aid led to a confrontation with Secretary of State Alexander Haig, and Energy Secretary James Edwards was rankled by Stockman's pre-emptive announcement of the decision to decontrol oil prices. But Reagan doesn't seem to mind. "We're talking about taking on 40 years of spending practices," says a top White House aide. "We couldn't do it unless somebody honchoed it from the beginning."

'Comet': Stockman, a bachelor, honchos the budget eighteen or nineteen hours a day, seven days a week—a regimen that he concedes to be "certifiable" workaholism. He lives modestly—aside from his salary, his assets last year were not more than $50,000—and rises at 5 a.m. He reads for an hour and then, still reading, is chauffeured to work. On a typical day last week he arrived at his office by 7 for interviews with prospective OMB staffers, drove to Capitol Hill for a meeting with Senate Republicans at 8:45, went back to the White House for a 10 o'clock session on regulatory reform and a 10:30 Cabinet meeting, then doubled back to the Hill for a working lunch. At 1:15 he joined Reagan in the Capitol to woo Congressional leaders, went to the Department of Health and Human Services at 3 for a budget huddle and got back to his office by 4. At 5:30 he was back on the Hill and at 7 he arrived at a dinner honoring Congress. He has little time to see his girlfriend, IBM representative Jennifer Blei, and a Reagan aide who sees him as "a bright comet in the sky," is already praying that he "doesn't burn out."

Stockman learned the work ethic early on, as a farm boy in southwestern Michigan—rolling, handsome country dotted with farms and small towns, as broadly Protestant as it was traditionally Republican. The oldest of Allen and Carol Stockman's five children, David helped with chores, studied hard and, his mother recalls, read anything he could get his hands on. At Lakeshore High in nearby Stevensville, he was president of the student council, an honors student and an undersized football and basketball player who always, his coach says, "gave 100 per cent." He worked for Barry Goldwater's ill-fated Presidential campaign in 1964—then went off to Michigan State University, where he suddenly was transformed into a campus radical. As the leader of a summer-long protest against the war in Vietnam, Stockman championed draft avoidance on campus and wound up under surveillance by the Michigan State Police. Their assessment, according to the State Journal of Lansing: "Dark, long brown hair, but clean and very good looking."

'Skepticism': His flirtation with the left only barely survived his graduation from Michigan State. He enrolled at Harvard Divinity School—partly to avoid the draft, friends say—and rediscovered conservatism. Sociologist Nathan Glazer and political scientist James Q. Wilson, two of his professors, remember him as a brilliant student who quickly followed their lead toward neoconservatism. Daniel Patrick Moynihan took Stockman into his household as a boarder. ("He may be the deputy assistant to the President," Moynihan says, "but to my daughter, he'll always be 'the babysitter'.") They spent hours talking, and Moynihan inculcated "a certain skepticism" about the left-liberal certitudes Stockman was spouting. Finally, Stockman recalls, "I had to reconstruct my whole philosophy and ideology"—which led him at last to a profound skepticism toward Big Government.

He also caught the political bug. When Illinois Congressman John Anderson showed up at Harvard for a public-affairs seminar, he offered Stockman a job on his Washington staff. Stockman quickly accepted, left Harvard without getting a degree and spent the next eighteen months in Anderson's office. But he was moving right, while Anderson was moving left. "I found the job fascinating," Stockman says, "although I couldn't support most of his positions by the time I left." He spent three years as director of the House Republican Conference, which was at that time chaired by Anderson, and in 1975 went home to Michigan to run successfully for Congress.

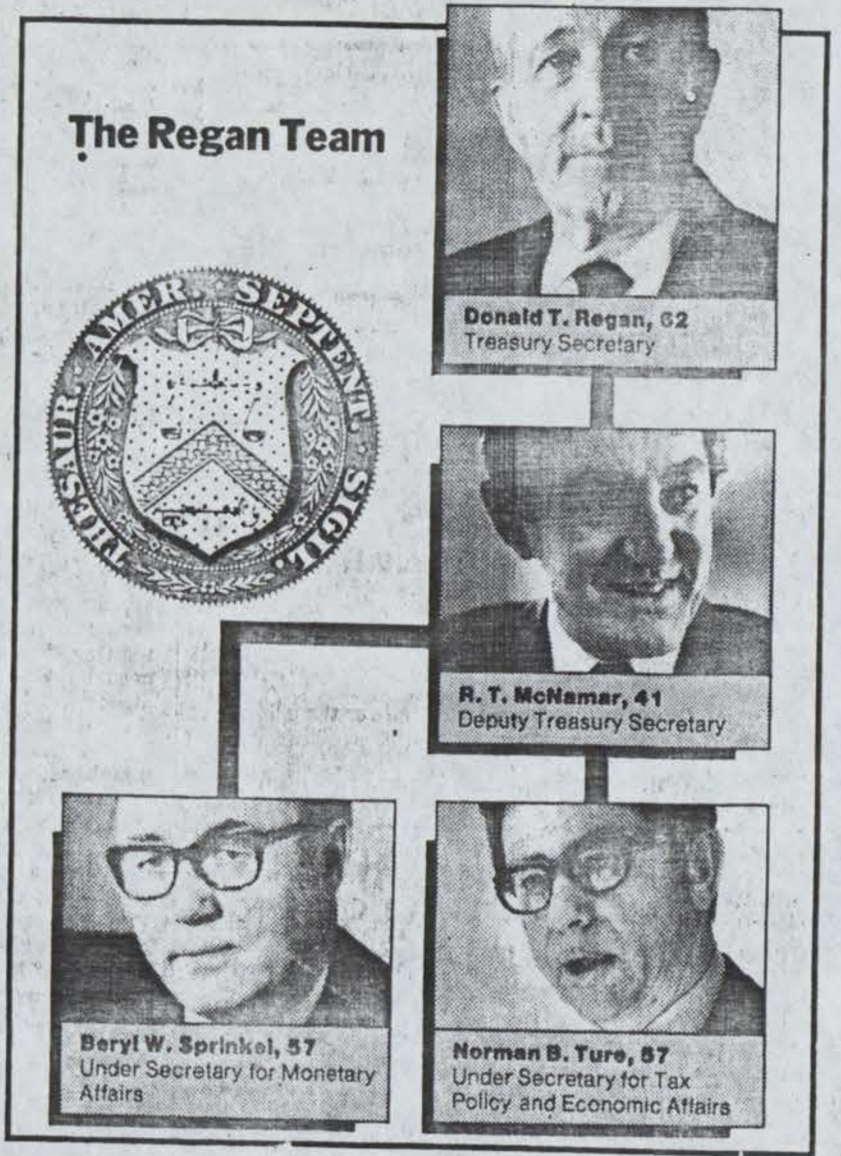
He was quickly recognized as a forceful young conservative—brash to some, arrogant to others, but unmistakably on the rise within the ranks of House Republicans. "He intimidated some of the older guys," says one GOP staffer. Taken in tow by Rep. Robert Michel, then Minority Whip, Stockman gradually learned to rein in his impatience and, during his second term, to win votes for his neoconservative views. He fought the windfall-profits tax, synfuels subsidies and the Chrysler loan guarantees, but lost on all. He joined conservative Democrats in defeating the hospital-cost-containment bill, and his trenchant critique of Jimmy Carter's first gasoline-rationing plan led to its surprise defeat. For all his zeal, Stockman proved himself to be "more pragmatic than ideological," Michel says.

'Rough Edges': When he left Congress for OMB, Stockman tried to pick his own successor—angering some Michigan Republicans who view him as arrogant, even ruthless. There are still, a friend concedes, "some rough edges with David, as there would be with anybody who has this much authority at the age of 34"—but his rapid rise to power rests on the confidence he has inspired in the Reagan White House. Stockman must make the most of the new Administration's honeymoon if he is to succeed in dramatically cutting the budget. By taking the lead, he has volunteered for the risks of failure along with the rewards of success—and his ambitious gamble is Reagan's as well.

TOM MORGANTHAU with ELEANOR CLIFT, THOMAS M. DeFRANK, RICH THOMAS and ELAINE SHANNON in Washington and TONY FULLER in Michigan

Work ethic: With grandparents after 1976 win, as divinity student, in high school

The Ferment in Regan's Treasury



The new Secretary seems to shift positions on tax and spending. Will supply-siders overwhelm him?

By STEVEN RATTNER

WASHINGTON

TO the casual eye, little has changed in the Treasury Department. The portraits of past Secretaries still stare down from the walls in a corner of the second floor. Bureaucrats bustle through the marble-floored corridors. Even the offices of the top officials remain unchanged — redecorating has been banned for budget reasons.

Yet all is not quiescent in this house of finance. Already, as rarely in the past, the Treasury Department has emerged as a seat of intellectual ferment.

How the new Treasury will function — and whether ferment will become turmoil — depends on how easily men representing a variety of economic viewpoints mesh their different outlooks and how well the new Secretary will be able to bring an intellectual discipline to men who in the past have mostly been free spirits.

The new Secretary, Donald T. Regan, is himself at issue. Widely expected to be a voice of pragmatism and restraint in an Administration heavily populated with economic ideologues, he has delivered himself of a variety of remarks — sometimes ambiguous, sometimes conflicting, but always impressive in style and force — that have left the distinct impression that he will not fill his anticipated role.

The varying statements illustrate both the multiplicity of viewpoints now at work in the Treasury and the task the 62-year-old former chairman of Merrill Lynch faces in overcoming his lack of Washington experience. David A. Stockman, director of the Office of Management and Budget, has already shown signs of usurping the preeminent role in economic policy usually filled by the Treasury Secretary.

"I don't understand his latest public statements which do not coincide with his previous public and private statements," said Representative James R. Jones, Democrat of Oklahoma and chairman of the House Budget Committee, of Mr. Regan. "My only concern is whether he is fully in the decision-making loop."

Take, for example, the matter of budget cuts and tax reduction. All of the senior Administration officials argue publicly that both are needed and that they should occur as simultaneously as possible. But in the practical world, simultaneity is unlikely and the Reagan Administration has been pressed on whether it would accept tax cuts passed before budget reductions are voted.

At his confirmation hearing on Jan. 6, Mr. Regan described the reduction of projected Federal spending and the easing of government regulation as "the more important parts" of the Reagan program. "Then we cut taxes," he said.

Exactly three weeks later, Mr. Regan told the Senate Appropriations Committee that the "tax program cannot wait until budget outlays are reduced." And he maintained, "We must not make the mistake of assigning a higher priority to balancing the budget than to revitalization of the economy."

He took much the same stance in a luncheon last week, rejecting suggestions that the tax cut be made contingent on achieving spending restraint. But the next day, a senior White House official pointedly disputed the Regan remark, insisting that the two proposals were

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The Ferment in Regan's Treasury

Some feel David Stockman is seeking control of tax policy.

Continued from Page 1

linked. Privately, senior Administration officials concede that Mr. Regan's conflicting statements reflect in part the fluctuating influences of Mr. Regan's senior aides. Within the group, the conflicts seem to result less from philosophical differences than from differences in emphasis, as in the case of the timing of tax cuts. All of the officials emphatically endorse the need for the entire program of tax cuts, budget cuts, tight control over the rate of growth of money and credit and reductions in regulation.

"What the Secretary started out to do consciously from the beginning was to put together a team bringing various perspectives to the Treasury," said R. T. (Tim) McNamar, the new deputy secretary. "We've got an economic situation to which there is no one answer."

Dominant at least in terms of numbers are the supply-side economists, a loose term for a group that stresses the positive effects of tax cuts, particularly on industry. The most senior exponent of that concept is Norman B. Ture, the Under Secretary for Tax and Economic Policy and formerly a Washington economic consultant. Mr. Ture, who was viewed as a liberal in the 1950's, has gradually become more conservative and in recent years has been touting an economic model showing that the 30 percent, three-year tax cut known as Kemp-Roth would result in major increases in employment by stimulating demand and, therefore, industrial activity.

WITHIN the Administration, Mr. Ture, who is known for holding strong views, has forcefully advocated that the tax cuts take effect as soon as possible and that a large "capital cost recovery" provision be enacted that would allow business to write off new investments faster. Mr. Ture is also arguing that other tax changes such as the marriage penalty should be placed in a separate package.

In Mr. Ture's economic shop are two men of like views: Paul Craig Roberts, the Assistant Secretary for Economic Policy, who was part of the group that worked on the Kemp-Roth proposal, and his deputy, Steve Entin, who was a staff member of the Joint Economic Committee for Senator William V. Roth, Republican of Delaware and cosponsor of Kemp-Roth. (Two other former Roth aides are directing legislative affairs at the Treasury.)

But on the tax side, Mr. Ture's assistant secretary is John E. Chapoton, a Houston lawyer who served as tax legislative counsel in the Treasury. Among the first things Mr. Ture did when his subordinate arrived was to give him some reading materials on supply-side economics. Reports of tension have already filtered out.

Meanwhile, the Under Secretary for Monetary Affairs is Beryl W. Sprinkel, a principal advocate of monetarism, which emphasizes the need for the Federal Reserve to make the money supply grow more slowly and less erratically.

"We're not going to be reluctant to suggest to the Federal Reserve the kind of monetary policies we think they should be following," said Mr. Sprinkel. "We don't have to wait to balance the budget to get inflation under control."

But in the past, most of the Under Secretary's job has involved international monetary matters, in which the 57-year old former chief economist for the Harris Trust and Savings Bank in Chicago has comparatively little experience. "There are some areas in which I'm well informed and some in which I'm not well informed," he said.

Before Mr. Regan's recent pronouncements, Treasury watchers felt that he and Mr. McNamar would constitute a third group with a more even-handed view of the various policy alternatives.

Mr. McNamar, an energetic and engaging 41-year-old lawyer and businessman, who was most recently executive vice president and chief financial officer of the Beneficial Standard Corporation in Los Angeles, describes himself as an "orthodox Republican," by which he means that he relies on no one solution. "We need a variety of actions," said Mr. McNamar, who was executive director of the Federal Trade Commission from 1973 to 1977.

Although Mr. Regan rejects the notion that he is possessed of a traditional Republican economic philosophy, and although he was known on Wall Street as something of a mavarick, his few public statements on economic policy before his appointment suggested a different emphasis.

Back in July, Mr. Regan called for a tax cut and talked of the need for incentives, much as he is doing now. But then, his priorities were a little different. First came accelerated depreciation, second, lower capital gains taxes and, third, protecting taxpayers against being pushed into higher tax brackets by inflation, a change that would give proportionately more relief to middle- and lower-income taxpayers than would Kemp-Roth.

Mr. Regan was also viewed as suspect by the most conservative Republicans for having supported wage-price controls in 1971 and for having lent at least tacit support to Democratic candidates, including Jimmy Carter.

While his statements have sometimes caused concern, Mr. Regan's manner of delivery has won universal praise. In meetings, the native of Boston has impressed even hardened Washingtonians with his crisp responses, steady gaze and sharp mind.

"He comes across as strong and forceful but with a sense of humor," said Charls E. Walker, a former Treasury Deputy Secretary under former President Richard M. Nixon, after a breakfast session. "He made his points and made them very clearly."

Mr. Walker also praised Mr. Regan for assembling a Treasury team quickly, probably second only to Alexander M. Haig Jr. in the State Department in speed. But other Treasury watchers also question whether Mr. Regan actually chose the team, virtually none of whom he had met before their job interviews, or whether it was pushed onto him.

Mr. Ture, for example, was reportedly at the head of a list prepared by the "kitchen cabinet," the group of California businessmen that President Reagan relied on in the early stages after his election. Mr. Regan's principal selection has been his New York public relations aide, John Kelly, who also lacks Washington experience, to fill a similar post here.

And officials such as Representative Jones wonder about the extent to which Mr. Regan is shaping Administration policy in view of the highly visible role taken by Mr. Stockman. At the outset, Mr. Regan's lesser role was attributed to his lack of experience; now, questions are being raised. "Tax policy has always been the domain of the Treasury, but now it looks like Stockman's grabbing for that too," said one concerned Treasury official.

For his part, Mr. McNamar argues that the Treasury has been trying to keep a low public profile in part because only Mr. Regan has won Senate confirmation and that "Treasury has been at every budget-cutting meeting." In addition, the economic policy council, which replaces President Carter's economic policy group, has not yet started up.

"You're talking about the first 30 days," said Mr. McNamar. "The Administration is not speaking with one consistent economic view yet, and when it does it will be Donald Regan's." ■

Epic Political Struggle Looming, Washington Officialdom Realizes

POLITICS, From A1

address Thursday night was the first display of these tactics.

But the budget process takes Congress most of the year to complete, and it is beyond the power of the White House to accelerate that schedule. Reagan can win some quick skirmishes, for example in his effort to reduce the current budget by about $14 billion, but the truly revolutionary cuts he seeks in fiscal 1982 and beyond won't be voted on until much later.

This unavoidable delay will give the special-interest groups — from welfare mothers to dairy farmers to Exxon and Boeing — ample time to mobilize their political forces to try to frustrate the administration's proposed cuts. "There are probably 35 meetings along the K Street corridor right now, trying to plan how to stop this," one White House official said with evident relish for the battles ahead.

The outcome of this contest remains unpredictable, not least because unforeseeable events can easily prove decisive. For example, the White House is hoping to keep national attention focused on the budget issue until it is resolved, but an international crisis — a Soviet invasion of Poland, say — could distract both the country and the White House, opening up new maneuvering room to the interest groups.

But there is widespread agreement on this point: Reagan seems to have an opportunity for success which his predecessors lacked, a sense of political readiness and nervousness that simply was not present in previous seasons of much-heralded budget cutting. Two dozen interviews with White House officials, members of both houses of Congress and professional lobbyists suggest both why Reagan could win his crusade, and what might tear it apart.

Administration officials and their allies in Congress suggested these elements are necessary ingredients in a winning strategy:

• A demonstrably fair plan for budget cuts, in which all special interests are seen to share in the sacrifices. This has been Stockman's objective all along, though some Republican members of Congress fault him for leaning too heavily on poor people in his initial planning. Stockman even hopes to surprise Congress by proposing some cuts in the Pentagon's budget, though these will be more than matched by new increases.

The theory of a balanced package of cuts was summed up neatly by Tom Korologos, a prominent Washington lobbyist who is close to the White House.

"If the Business Roundtable isn't furious when this is over," Korologos said, referring to the group that represents the sentiment of America's biggest corporations, "it will have failed. Everybody has got to scream equally — a loud outcry. Then it might fly."

Of course, fairness of this kind is much easier to describe than to achieve. Some of the oxen that will be gored by Reagan's budget cuts will never believe that they are suffering "fairly," and will fight back accordingly.

One key White House official who asked that his name not be used said at the end of the week that after the first leaks of the Reagan cuts he was "really surprised at the reaction on the Hill." People he expected to be fiercely opposed to the cuts are accepting them with unexpected equanimity, this official said.

• Preservation of the post-election political mood in Washington, which is clearly favorable to Reagan's cause. Politicians from liberal Democrats to arch-conservative Republicans agree that November's surprising results — both Reagan's large margin of victory, and the Republicans' unexpected gains in Congress — have intimidated even the House Democrats who remain in control of that body.

Rep. Thomas S. Foley (D-Wash.), the new majority whip in the House, said last week that "there's a consensus growing in the Congress" in favor of less government spending, fewer government regulations and simplified government programs. "The inflation level is the most serious issue facing the country," Foley said.

If even liberal Democrats are talking like that, Reagan clearly has an advantage. "I think the climate is somewhat intimidating," said Rep. Barber Conable (N.Y.), the ranking Republican on the Ways and Means Committee. "Of course, the conventional wisdom is that this climate won't last long."

• The evolution of shifting coalitions of budget-cutting members of both houses to head off the pet projects of key members. Sen. Jesse Helms (R-N.C.) is a convinced budget cutter, but he doesn't want to touch the tobacco subsidies so important in his home state. If he can protect them — or if the dairy industry's many friends in Congress can protect dairy subsidies, or if the western senators and representatives preserve all the expensive water projects — the spell of unity Reagan hopes to cast will be broken. Other interests will pursue their pet projects with renewed indignation. The Stockman plan will be plucked and pulled from every direction at once. White House officials say they are keenly aware of this problem.

• Top-flight lobbying work all year. After last week's vote to raise the debt ceiling in the House, when three-fourths of the Republicans were persuaded by the White House to support a measure they had all but unanimously opposed in the past, Rep. Richard Bolling (D-Mo.), chairman of the Rules Committee, observed: "The day of the amateur [president] is passed . . . These guys are really going to be playing legitimate, effective hard ball."

These same people see many different ways that the new president's crusade could be frustrated, too. Among them:

• A loss of nerve among Republicans who can't stomach cuts of the programs that many of their constituents depend on. Sen. Bob Dole (R-Kan.) said last week that he has repeatedly reminded the White House that six of the Republicans on the Finance Committee he now chairs will be up for reelection in 1982, and thus will have to answer for whatever the Republican-controlled Senate has done in the interim.

If a united front is broken, several Republicans in both houses said, the whole plan could quickly unravel.

• A changed atmosphere on Capitol Hill. A serious economic downturn, for example, could revive traditional congressional instincts and promote a new round of pump-priming through the federal budget. "You've got 100 senators each holding one finger up in the air to see which way the wind is blowing," said an aide to a prominent Senate liberal, who admitted that today's wind is favorable to budget cuts.

• An outbreak of regional warfare in Congress. Many of today's big government programs — all of which Reagan will try to trim — were the product of elaborate regional compromises. For example, food stamps and price supports and subsidies for farmers have traditionally been seen as a trade-off between rural and urban members of the House. Northern members made trades to win Sun Belt support for the fuel-aid program to help poor people pay for their heating oil or gas. Western members traded votes on matters of interest to northern and eastern colleagues to win support for their water projects.

If the budget-cutting process destroys any of these explicit and implicit arrangements, "there's a real danger of sectionalism dividing the Congress," said Sen. Patrick J. Leahy (D-Vt.).

• Squabbling between members whose first interest is tax cuts and those who are more anxious about spending cuts.

So far, Stockman has held the two camps together by allying the new administration with both of them. But there are members of both parties who would be perfectly willing to vote tax cuts before spending cuts are agreed on, and others who will fight such a move bitterly.

In the end Reagan's most formidable foe may be the traditions of politics as usual that have governed Capitol Hill for so long. The new president wants a revolution in bread-and-butter politics, but many in Congress can be expected to offer him half a loaf.

Epic Political Struggle Looms

Official Washington Realizing Reform Crusade Is Not Business-as-Usual

By Robert G. Kaiser
Washington Post Staff Writer

David A. Stockman's big black book of budget cuts, 145 pages of numbers and fine print, makes tangible what official Washington was already beginning to grasp: the Reagan crusade for federal reform is not business-as-usual. It promises, instead, to produce a year of epic political struggle unlike anything seen before in modern Washington.

When President Reagan presents his detailed economic proposals 10 days from now, the struggle will begin in earnest. In the meantime, the budget-cutting prospectus prepared by budget director Stockman and obtained yesterday by The Washington Post will be the best-read official document in the capital, widely circulated and scrutinized in Congress and in lobbyists' offices.

The sum of its details is breath-taking: enormous reductions proposed for long-familiar and popular federal programs. Stockman proposes to cut scores of billions: in some cases he would cut the benefits that significant elements of the population depend on for their survival.

In the first days of his presidency Reagan has apparently settled easily into the idea of fighting this radical crusade, which in fact is closer to the apocalyptic rhetoric of his early political career than the soothing reassurances of last year's presidential campaign. Candidate Reagan often seemed to be saying that the only thing that had to be cut was federal taxes in order to restore the country's economic well-being. Now President Reagan predicts "an economic calamity of tremendous proportions" unless radical surgery is performed on the federal budget.

The difference between the campaign rhetoric and the new budget-cutting crusade is one of the political problems that the administration will have to conquer to prevail. "The candidate in 1980 who asked for sacrifice," recalled Rep. James R. Jones (D-Okla.), chairman of the House Budget Committee, "lost the election." But now the man who won will be asking for literally unprecedented sacrifices from individual Americans and some formidable interest groups.

Many in the White House, including Stockman, who is the principal architect of the budget-cutting plan, believe speed and momentum are crucial to their success. The idea is a political blitzkrieg backed by a persuasive president's direct appeals to the nation for support. Reagan's televised

See POLITICS, A20, Col. 1

Reagan Budget Team Proposes Cuts Across Broad Spectrum

8/2/81

By Ward Sinclair and John M. Berry
Washington Post Staff Writer

President Reagan's budget architects have put together an extraordinary package of proposed budget cuts touching every level of American society and dismantling dozens of popular federal aid programs that support everything from school lunches to airports, public television and welfare.

The sweeping nature of the spending cuts being considered by the Reagan administration is outlined in documents prepared as prelude to presentation of the president's economic policy program Feb. 18 and obtained yesterday by The Washington Post.

The budget documents, prepared by David A. Stockman, director of the Office of Management and Budget in the Reagan White House, were circulated confidentially last week among key senators and House members who will preside over the budget and appropriations action this spring.

For example, the Stockman budget book proposes for fiscal 1982:

- A massive revamping and rewriting of federal school aid policy, with a consolidation of at least 57 programs into a scheme of block grants that would go to the states to spend as they see fit. But the school aid would be reduced by 20 percent from what the states receive.
- A $990 million reduction in child nutrition programs on top of at least a $400 million cut proposed by the Carter administration.
- The abolition of the Economic Development Administration, including all its $425 million in loan guarantees, an end to the $3.7 billion public service jobs (Comprehensive Education and Training Act) program, and shutdown of the Appalachian Regional Commission and nine other sister regional commissions.
- A $1.3 billion reduction in highway, rail, airport and mass transit aid that would doom completion of the full 101-mile Washington Metro subway system.

House Democrats tomorrow will get, by courtesy of the Democratic Study Group (DSG), a first look at these probable budget slashes totaling $26.2 billion. Another $10 billion to $20 billion worth of reductions are anticipated before Reagan formally sends his unprecedented budget changes to Capitol Hill.

The early delivery of the detailed cuts — obtained independently by the DSG — seems certain to set the tone for what will be a knock-down, drag-out brawl over Reagan's efforts to scuttle dozens of aid programs that have acquired forceful advocates during the last two decades. Even in the Senate, now controlled by the Republicans, a melee is assured. "We don't interpret Reagan's victory last fall as a mandate to scuttle all these programs," said an aide to a key tax-writing Democrat.

While some of the details of the budget proposals have filtered out

See CUTS, A14, Col. 1

Excerpts from 145-page OMB document on budget cuts. Page A15.

President's Budget Team Readies Broad, Deep Cuts

CUTS, From A1

sporadically in recent days, the full scope of the sharp alteration in federal support for so many activities — and the pain they are certain to cause — leaps from the pages of Stockman's catalogue of cuts.

Stockman yesterday declined to comment on the specifics of OMB's proposals, saying only, "It's all still in the option stage, but the options are firming very quickly."

President Reagan, who has approved many elements in the program already, must clear these and other issues this week in order to meet his timetable for his economic message to Congress in 10 days.

Another unusual side to the Stockman proposals is the "probable reaction" assessments sketched out by OMB draftsmen as part of the presentation and defense of the projected slashes. On most proposals, the OMB foresees stiff opposition from Congress, state and local governments, as well as from labor, business and social welfare organizations.

Even at that, however, the GOP White House apparently is counting on support from friendly Democrats to carry through with the swing of the cleaver. In contemplating a $671 million chop of aid to families with dependent children (AFDC), for example, OMB says the likelihood of winning "seems good," with leadership expected from Sen. Russell B. Long (D-La.), who until this year was chairman of the Finance Committee.

The sweeping changes proposed in the energy area total $6.4 billion, with the budding synthetic fuels program virtually wiped out. Support for solar energy and energy conservation are more than cut in half.

The reduction of $712 million in synthetic fuels money in 1982, and much larger reductions in loan guarantees, is justified on the grounds that the private sector can do the job and that it is not up to the federal government to build synfuels plants.

As for an assessment of the probable backlash, the OMB documents state: "The proposed actions would be strongly opposed by project sponsors and the array of business and labor interest that would benefit from [a] government-subsidized construction program (architect engineers, constructors, suppliers, labor unions, and development interests in areas where plants are to be built).

"Also," the document continues, "the popular perception that synfuels are a way of reducing dependence on imported oil and holding down OPEC prices would produce negative public and media reaction. Congressional delegations from West Virginia, Kentucky, Ohio, Alabama and Illinois would be affected."

Similar arguments are made for cutting back money for energy conservation activities: "Supported by existing tax credits, individuals and businesses are already making substantial conservation efforts, which will be accelerated by oil and gas decontrol. In light of these trends, much current federal activity is superfluous or imposes too great a regulatory burden on the public."

It's not just private business and individuals that are in many cases to be left to their own devices, but so are quasi-public organizations such as the Tennessee Valley Authority.

Financially, TVA will fight its own battles, with 1982 outlays cut $762 million. OMB suggests TVA should borrow money on its own, not through the Federal Financing Bank, and that it should scale back its planned construction of generating plants, including deferral of three nuclear plants.

The nation's rural electric and telephone cooperatives, who collectively constitute the biggest borrowers for whom the Treasury Depoartment's Federal Financing Bank raises money, would also be left to their own devices in the capital markets.

In keeping with the administration's avowed aim of looking at all federal programs, the OMB proposals also go after some of the "silk-stocking" outlays of government spending.

The national endowments for the arts and the humanities would be ticketed for an $85 million reduction in their grant-awarding programs, while public broadcasting would see its support shorn by $43 million. In both cases, Stockman's aides acknowledge the sensitivity of their assault, predicting an outcry from constituencies they describe as "articulate and politically active."

But in another sense, the proposals seem destined to provoke cries of anguish from traditionally less articulate sectors — children, for one; the poor and the sick, for another. The OMB master plan, despite frequently stated administration commitments to protecting programs for the "truly needy," touches them nonetheless.

As an example, the plan envisions a saving of $1 billion through placement of a cap on federal spending for Medicaid, the health program for the poor. OMB projects an annual saving of $5 billion within three years if Congress goes along with the cuts.

Pages From Budget Director

THE WASHINGTON POST Sunday, February 8, 1981 ... R 1

Stockman's 'Black Book'

Following are excerpts from the 145-page document listing the Reagan administration's contemplated spending cuts. In most cases the budget cutters have set forth the rationales for their proposals and forecast the likely reactions in Congress and among affected interest groups. Listed cuts are from the so-called current services budget, which sets forth what spending would be in fiscal 1981 and 1982 under current law and economic assumptions, absent any changes in policy. All figures are in millions of dollars and in projected outlays — money the government is expected actually to spend.

Medicaid

	1981	1982
Current Estimate	16,483	18,215
Proposed Savings	100	1,013

Current Program: Medicaid is a program of grants to States to assist them in providing medical insurance coverage to the poor.

Potential Change: The savings identified above could be achieved if an interim cap were imposed on federal Medicaid spending while proposals for fundamental program reforms are developed. The cap would limit federal grants a level $100 million below the 1981 spending estimate, and allow a 5 percent increase in 1982, $1 billion below the current spending estimate. After 1982, federal spending would be allowed to rise only with inflation. States would be given additional flexibility to adjust payment rates for providers, to organize more cost-effective systems of care, to change covered services, and to adjust eligibility in order to live within their allocated share of the expenditure cap.

Medicaid spending has risen faster than 15 percent annually over the last five years. Only capping federal payments can produce significant budget restraint under present conditions.

The interim cap will allow each state to maintain its current real share of total federal Medicaid spending. The effects of the cap however, vary from state to state, depending on projected rates of expansion and the methods adopted to reduce program costs. Based on current state projections for 1982, all but 3 states will have reimbursements limited as a result of the cap. Nine states now consume 55 percent of all federal Medicaid dollars. New York and California alone generate 27 percent of all federal Medicaid costs. The increased state flexibility proposed . . . will enhance states' ability to improve the cost-effectiveness of the program and to make appropriate adjustments in eligibility. Nevertheless, some states are likely to respond to the cap by withdrawing needed services from the poor and by excessively constraining payments to providers.

Probable Reactions: Most states will object strongly to imposition of a federal cap on Medicaid, although welcoming the proposed increases in flexibility. In addition, provider groups, especially hospitals, may balk at limited payment rate reductions stimulated by the cap. These groups might add their voices to the normal welfare constituency in the Congress. In view of the current inequities in the program, it will be important to emphasize that the cap is a temporary measure while proposals for fundamental reforms are developed.

Disability Insurance

	1981	1982
Proposed Savings	125	600

Current Program: Disability Insurance (DI) benefits are paid to disabled workers and their families. The costs of disability insurance have grown by leaps and bounds.

Potential Changes: (1) Improve administration to reduce payments to ineligibles — Unpublished Social Security Administration (SSA) Pilot quality Control studies indicated a 15-20 percent DI error rate, with most of the misspent funds going to individuals misclassified as disabled.

A top-flight management team, starting immediately and operating under current law, could produce sizeable savings starting in FY 82.

(2) Institute a "megacap" — A megacap would limit related disability benefits so that they do not exceed a worker's prior after-tax earned income. The rationale is simply that individuals should not receive more while disabled than they were paid for working. The largest federal program offsetting DI benefits would be veterans compensation benefits.

Excluding veterans compensation benefits would markedly reduce the savings associated with a megacap.

Excluding state worker's compensation or private disability insurance benefits also would reduce the savings from a megacap. Reducing DI benefits for private insurance payments could be seen as taking private property from individuals who chose to insure themselves.

Provide a stricter recency-of-work test: Workers who had social security covered earnings up to 5 years ago but not since are eligible for social security disability benefits.

Opponents to this change would make emotional appeals about vulnerable people being excluded from benefits, such as the disabled, widows mothers and dependent children.

Probable Reaction: Congress may be reluctant to again reform disability insurance. The 1980 DI reforms focused on eliminating excessive benefits for the disabled. Seeking major cuts in disability benefits might be viewed by advocates as an assult on America's social insurance "safety net."

Social Security Student Benefits

	1981	1982
Proposed Savings	100	700

Current Program: Full time students age 18-21 are entitled to social security benefits as dependents of retired, disabled or deceased workers. Approximately 800,000 students now receive benefits from this program. The average social security student benefit is $255 per month and ranges from a low of $20 to a high of $700.

Potential Changes: The students benefits program should end. New recipients should be prevented from entering the program, and existing recipients' benefits should be reduced by 25 percent over the next four years.

Arguments for Ending Program:

The benefit is inapporopriate for the social security program — Social security protects against loss in income from risks (old age, disability and death) which are beyond the worker's control. Continuing the child's benefits past age 18 because of their choice to go to school ahould not be an insurable risk.

The benefit is poorly designed as educational assistance expenses.

Educational assistance is provided more equitably and efficiently under other programs

The social security trust system can no longer afford this drain on its funds.

Program participation rates and costs have exploded since 1965 enactment.

Probable Reactions: Recommemdations by the Carter administration to reduce or abolish these benefits have not even gained serious consideration on Capitol Hill. Severe opposition by present and future beneficiary families, Social Security advocacy groups and the higher education establishment can be anticipated.

The new Congress may be more responsive to trimming this program on merit, particularly when the savings are needed to maintain the overall soundness of the social security system.

Minimum Social Security Benefits

	1981	1982
Proposed Savings	200	1,000

Current Program: A minimum initial benefit of $122 per month is given to social security recipients who otherwise earned a lesser amount.

Potential Changes: Both GAO and various social security advisory councils concluded that the minimum benefit has outlived its usefulness and generates undesirable windfalls. It was originally adopted to assure that benefits paid to retired workers were larger than welfare payments.

The original rationale for the minimum benefit makes no sense today. The Supplemental Security Income (SSI) program, enacted in 1972 for the needy aged, blind and disabled pays benefits which are about double the social security minimum benefit ($240/month).

Because SSI benefits would be increased by the amount social security benefits were reduced, eliminating the minimum benefit would not affect truly needy recipients. Of the 3 million minimum beneficiaries, less than half would lose a single dollar if the minimum benefit were eliminated.

According to GAO, 74 percent of minimum income recipients do not "depend primarily" on social security benefits. This includes 15 percent who have federal government pensions averaging $900 per month and 10 percent whose working spouses earn at least $14,000 per year. Eliminating the minimum benefit tends to even out the income distribution among retirees by reducing incomes among the better-off without affecting incomes among the worst-off.

Probable Reactions: Doing away with the minimum benefit makes programmatic sense and has been recommended by GAO. However, those recipients who would lose a portion of their income would lobby fiercely against minimum benefit elimination. Eliminating the minimum could be painted as a first step toward dismantling social security, resulting in heightened resistance to other social security reforms.

Unemployment Insurance Extended Benefits

	1981	1982
Proposed Savings	568	2,162

Current Program: The regular unemployment insurance system pays benefits for up to 26 weeks (in most states) to experienced workers. Up to 13 more weeks of extended benefits become available ("trigger on") when either individual state unemployment rates or the national rate exceed certain levels. The national trigger has been on since summer 1980, and under current assumptions would remain on through three quarters of FY 1982.

Potential Changes: (1) Eliminate the national extended benefit trigger. When the national insured unemployment rate (the ratio between unemployment claimants and the number of workers covered under the program) exceeds 4.5 percent, extended benefits become available to workers in all 50 states, regardless of the unemployment rate in a particular state. Eliminating the national trigger would restrict extended benefits to states with high unemployment rates and demonstrated need.

(2) Change the method of calculating the trigger rate.

(3) Increase state trigger levels. Currently a state must pay extended benefits when its insured unemployment rate is at least 4 percent and at least 120 percent of its experience in the prior two years. A state, if it wishes, can pay them when its insured unemployment rate exceeds 5 percent. These limits could be raised to 5 percent and 6 percent.

(4) Strengthen and enforce the work test. Unemployment insurance recipients are supposed to be available for and seeking work at all times. However, state enforcement of this requirement is very uneven.

Potential Reaction: The first three changes would require congressional action on substantive legislation; the fourth would require appropriations action. Lobbying against the proposals, particularly by organized labor, would be intense. Eliminating the national trigger and changing the trigger rate calculation have been discussed on the Hill before and do enjoy support, particularly in the Senate, which in the last session passed legislation eliminating the national trigger.

Trade Adjustment Assistance

	1981	1982
Proposed Savings	—	1,000

Current Program: The Trade Adjustment Program pays benefits in addition to unemployment insurance to workers when increases of imports "contribute importantly" to their losing their jobs. Benefits are liberal (70 percent of prior gross earnings — up to the average weekly manufacturing wage, now $269) and extend to 52 weeks. Workers over age 60 or in approved training can draw 26 additional weeks. TAA was enacted to gain approval of a less restrictive international trade policy by those concerned with the effect of imports on jobs.

Potential Changes: Implement GAO recommendations to limit TAA to people who have exhausted their unemployment insurance (UI) benefits; cap TAA benefits at UI benefit levels; and limit the duration of TAA and UI benefits combined to 76 weeks.

Or, same as above, but limit duration to 52 weeks. The hardship felt by workers eligible for TAA is no worse than for other unemployed workers, who are now subject to a 39-week benefit limit. For those with permanent problems, 52 weeks of TAA should provide sufficient time to get training, relocate, or find adequate new jobs.

Potential Reaction: Organized labor, particularly the Steelworkers and the UAW, will strongly oppose attempts to curtail TAA, particularly to reduce benefits for current claimants. Last year the House passed a bill expanding the TAA program. There is, however, considerable sentiment that something must be done to control this program which has grown far beyond expectations.

Food Stamps

	1981	1982
Proposed Savings	—	2,600

Current Program: Food stamps subsidize the food purchases of low-income households. Each household meeting eligibility requirements — —an income test, an asset test and a work requirement — receives stamps redeemable for food purchases. Stamp allotments vary by household size and net income level. Allotments are annually indexed based upon changes in the Thrifty Food Plan, USDA's lowest cost plan for a nutritionally adequate diet.

Potential Changes: Savings would be achieved by adopting the following package of proposals:

- Food stamp benefits would be reduced 35 cents rather than 30 cents for every dollar earned and gross income limits would be set on eligibility. Using gross household income instead of net income improves the low-income targeting of the program. Participation would decline by 2 to 3 million persons from these changes.
- Liberalizing amendments scheduled to take effect in FY 1982 relating to adjustments and deductions would be repealed. Current recipients would not lose any of their present benefits and no recipients would be dropped due to this change. Food allotments for families with school age children would be reduced to take into account free school meals. Approximately 43 percent of food stamp households (3 million) would be affected.
- Require income eligibility to be based on income in the prior quarter.

Probable Reaction: Enactment of the complete package is highly unlikely. Repeal of the scheduled 1982 liberalizations and increasing the benefit reduction rate with gross income limits are the most likely. Other proposals (school lunch offset, and quarterly retrospective accounting) may be more difficult.

Aid to Families With Dependent Children

	1981	1982
Proposed Savings	—	671

Current Program: AFDC is often viewed as the primary federal welfare program (although SSI spends as much, and food stamps 50 percent more, for the poor). AFDC is administered by the states with federal matching funds ranging from 50 percent to 83 percent.

Potential Changes: Advance payment of the Earned Income Tax Credit (EITC) — which goes to families with low-income earnings — would be assumed and counted against a family's monthly AFDC payment.

The income of step-parents would be counted in determining a child's elegibility and benefits for AFDC, in contrast to current requirements which do not assume any financial responsibility on behalf of step-parent. This proposal would eliminate the anomalous situation of a child being an integal part of a household that should be expected to support her/him and at the same time being a public charge.

States would be required to determine each month's AFDC benefits based on the family's income and circumstances in the previous month. This would replace the current prospective procedure of estimating future income and family circumstances to calculate benefits, which can result in overpayments and undetected ineligility.

Currently, an AFDC family's earned income may be offset by an unlimited amount of reasonably attributed work-related expenses, including child care, in determining AFDC benefits. Standardizing disregards would encourage greater economy by AFDC recipients in their work expenses, which could efectively increase their income available for other expenditures ($86-plus million savings).

AFDC payments below $10 per month would be prohibited.

Probable Reaction: The likelihood of congressional passage of AFDC items in this package seems good, with leadership expected on most items from Senator Long and the Senate Budget Committee. Opposition from the welfare lobbies can be expected on all AFDC items and, with regard to the retrospective reporting requirements, will focus on up-front administrative costs associated with the proposed change.

Health Planning

	1981	1982
Current Estimate	172	184
Proposed Savings	-20	-75

Current Program: The health planning program provides support for 213 local health systems agencies (HSAS) and 57 state health planning and development agencies (SHPDAS). The program has a dual charge: to assure equal access to quality medical care and to control costs; in practice, however, emphasis has been toward cost containment. The program's three primary methods of controlling costs are: 1) certificate of need review for new facilities construction or equipment purchase; 2) appropriateness review for existing facilities, and 3) proposed utilization of federal funds review for federal grant application.

Potential Change: This proposal would phase out federal support for the entire planning program over the 1981-1983 period. This policy action would be consistent with a two-year administration timetable for development and implementation of a pro-competitive bill for health financing reforms.

This proposal reflects three basic deficiencies of the current planning program:

- Inappropriate regulation. The health planning program is intended to restrain costs by limiting the supply of facilities and services. However, this approcach also inhibits market forces which are needed to strengthen competition and provide less costly services.
- Lack of effectiveness. The planning program has functioned under serious liabilities of attempting to impose a federal structure incompatible with many state and local political processes and attempting to restrain costs without altering the financing system which is the main contributor to excess costs.
- Federal/state/local responsibilities. The planning program is a highly visible example of the federal government seeking to impose national program, in exhaustive detail, on states and local areas. Continued support for the current planning program would thus appear to be a low priority in view of this administration's approach to returning responsibilities to appropriate levels of government.

Probable Reaction: Some dissatisfaction with the present planning program is evidenced by the 15 percent reduction in 1981 funding for local health planning. Nevertheless, absent a viable pro-competition alternative to cost containment, the current planning/regulatory approach has continued to maintain support. The strongest opposition to elimination of this program will come from the local health planning agencies and congressional supporters of a strenghened federal role in health care regulation. Some provider groups and Blue Cross, with stakes in the present non-competitive system, as well as states, may also oppose a complete end of funding. Most providers, however, will probably support program elimination.

Comprehensive Employment And Training Act

	1981	1982
Proposed Savings	946	3,708

Current Programs: Prior to 1973, a number of categorical, federally controlled programs were authorized by the Manpower Development and Training Act (MOTA) and the Economic Opportunity Act (EOA). In 1973, CETA combined most of these programs into a single block grant and transferred responsibility for their administration to state and local governments.

Potential Change: The savings above reflect total elimination of CETA subsidies for regular jobs in the public sector, by the end of FY 1981. Because CETA funds are available for obligation for two years and may be expended for up to two years after the date of obligation, maximum savings in outlays in 1981 and 1982 require phasing out the program in 1981.

Probable Reaction: State and local governments can be expected to oppose phase-out. Termination will diminish services in most jurisdictions, and in communities which engaged in heavy substitution, considerable problems could result. Organized labor can be expected to argue against any reduction, citing PSE as a way to reduce the unemployment rate, preserve, and enhance job skills provide valued output, and prevent a decline in public services. Strong opposition can be expected from minority groups since virtually all PSE participants are disadvantaged and almost half are minorities. Recycling some of the PSE savings into training programs could ameliorate the criticism, but would reduce overall savings.

Public Health Service Hospitals

	1981	1982
Current Estimate	158	161
Proposed Savings	-40	-100

Current Program: The federal government operates a system of eight general hospitals and clinics primarily to provide free medical care for merchant seamen.

Potential Changes: This proposal would eliminate the merchant seamen entitlement, the general hospitals and the clinic system on the following grounds:

The merchant seamen entitlement to free medical care at public expenses is inequitable and unwarranted.

Only 40 percent of the PHS system's patient care is now for primary beneficiaries (merchant seamen).

Occupancy rates of the hospitals have been hovering at 60 percent since 1978 compared to national minimum standards of 80 percent occupancy.

All of the hospitals are located in overbedded areas; and

All affected cities have at least one other federal facility operating at less than 80 percent occupancy to care for non-merchant seamen patient load entitled to federal care.

Probable reaction: There will be strong reaction from members of Congress whose constituency is affected by reduction of 5,000 federal jobs, but objection is not likely from other areas. Former senator Magnuson and former congressman Murphy . . . were primarily responsible for continuance of the system. The remaining hospitals are in Seattle, San Francisco, Galveston (Nassau Bay), New Orleans, Norfolk, Baltimore, Staten Island and Boston.

National Health Services Corps Scholarship, Placement Programs

	1981	1982
Current Estimate	151	187
Proposed Savings	-3	-14

Current Program: The NHSC provides federally employed physicians and other professionals to areas classified by HHS as health manpower shortage areas (HMSAS).

Potential Change: This proposal would eliminate all new scholarship awards in 1981 and 1982 on the following grounds:

• Rapidly diminishing access problems. Currently available data indicate that serious remaining problems of access to adequate primary care are rapidly being reduced and will probably be virtually eliminated within the next few years.

In addition, recent data indicate that physicians in general, and primary care physicians in particular, are voluntarily locating in smaller communities and that specialists in rural areas spend 30 percent or more of their time on primary care.

• Costs — Total program costs are very high. Federal costs now average $100,000 per physician for each year of scholarship obligated service. Alternative aid program would be more cost effective.

Probable Reaction: This proposal has a very good chance of gaining support from both Appropriations committees. The House committee has been highly critical of the NHSC placement process in recent years. There has been a higher and higher proportion of assignees placed with HHS grantees in urban areas as opposed to rural areas where the eventual establishment of a private practice is more likely.

National Endowment For Arts, Humanities

Humanities

	1981	1982
Proposed Savings	—	39

Arts

	1981	1982
Proposed Savings	—	46

Program: The National Endowment for the Arts and the National Endowment for the Humanities were first authorized in 1965. Most recently, the endowments were reauthorized in December 1980 for a five-year period, through FY 1985.

Potential Change: Reduce the budget authority of the arts and humanities endowments by 50 percent. The proposed savings reflect a 50 percent reduction in funding for arts and humanities programs beginning in Fiscal Year 1982. From Fiscal Year 1984 on for the arts and Fiscal Year 1985 on for the humanities, the endowments would be held level at $100 million.

Reductions of this magnitude are premised on the notion that the administration should completely revamp federal policy for arts and humanities support. For too long, the endowments have spread federal financing into an ever-wider range of artistic and literary endeavor, promoting the notion that the federal government should be the financial patron of first resort for both individuals and institutions engaged in artistic and literary pursuits. This policy has resulted in a reduction in the historic role of private individual and corporate philanthropic support in these key areas. These reductions would be a first step toward reversing this trend.

Moreover, even in those areas where federal financing does not wholly supplant private philanthropic means of support, it constitutes a low priority item. Given the need for fiscal retrenchment across the full range of human federal programs that meet more basic human needs, low priority items must bear a greater differential burden if fiscal restraint is to be achieved in a balanced and compassionate way.

Probable Reaction: The arts and humanities endowments have broad and articulate public constituencies, ranging from university presidents to museum directors to individual artists and scholars. In addition, most artistic and cultural institutions maintain strong ties to business and corporations through honorary appointments on boards of directors. A proposal to halve the budgets of the endowments could generate strong opposition.

Corporation for Public Broadcasting

	1981	1982
Proposed Savings	—	43

Program: The Corporation for Public Broadcasting is the primary vehicle for providing federal financial assistance to the 217 radio and 170 television stations that currently compose the non-commercial broadcasting system.

Potential Change: Sixty percent of CPB's budget is comprised of block grants to local stations, [and] 24 percent of CPB's budget goes to national program production. The CPB board would have to decide how any cut would be distributed among CPB activities. If a 25 percent reduction in fiscal year 1982 was directed primarily at administrative costs and national program production, support to local stations could be held relatively constant. Given the necessity for funding restraint and the need to cut out low priority items in the budget, a 25 percent cut is reasonable for 1982. Additional reductions would be made in 1983 and 1984 so that the funding for CPB would level out at $100 million in 1985.

Potential Reaction: CPB support goes to 387 non-commercial radio and television stations. These will probably object to a reduction in CPB funding since their non-federal support is barely keeping up with inflation. In addition, public broadcasting has millions of viewers, many of whom are articulate and politically active.

Child Nutrition

	1982	1983
Proposed Savings	-990	-1,200

Current Program: The child nutrition (CN) appropriation finances a variety of programs: school lunches and breakfasts, child care meals, summer meals, nutrition education, equipment assistance, and state administrative expenses. The lunch, breakfast and child care programs subsidize all meals served, but the subsidies vary in three tiers by household income level.

Restructure CN Subsidies: The Omnibus Reconciliation Bill made several changes to CN meal subsidies — some permanently, others only for FY 81. The Carter FY 82 budget assumes that the FY 81 reductions will be made permanent.

Additional legislative savings that should be proposed are:

- Reduce the base meal subsidy from an estimated 19.2 cents/meal to 9 cents in FY 82 and freeze it.
- Reduce the commodity subsidy for all meals from 15.9 cents/meal to 8 cents in FY 82 and freeze it.
- Reduce the special subsidy for students between 125 percent and 185 percent of poverty by 25 percent (from 74 cents to 55 cents in FY 82).
- Eliminate subsidies for snacks served in child care and summer meal progams.
- Require schools to verify the income eligibility of students on a 10 percent sample basis.
- Eliminate meal subsidies to private schools where yearly tuition exceeds $1,500.

Probable Reactions: Outlook for continuation of the FY 81 Reconciliation Act reductions is good. Further reductions will be difficult but not impossible to achieve.

CN advocates have had strong bipartisan support in the House Education and Labor Committee. If other cuts are not sought in their areas of interest, agriculture and education interest groups may coalesce to oppose these cuts.

Social/Community Services; Health Program Consolidation

	1981	1982
Proposed Savings	—	1,827

Current Program: The federal government finances a multitude of social and community services and health programs. These programs often serve narrow target groups and finance duplicatory services (e.g., family planning is financed by more than one HHS health program and in the Title XX social services program).

Potential Change: The programs listed are potential candidates for consolidation into one block grant to the states for 1982 and subsequent years, with funding at 80 percent of the sum of 1981 current services amount for each program.

Probable Reactions: States will generally support consolidation of several of these programs but will oppose major reductions in total funding (in fact, they will probably seek automatic indexing of federal funding — some states may also seek redistribution of funds among states). Specific interest group (e.g., vocational rehabilitation), in addition to opposing the overall funding reduction, will strongly oppose the discontinuance of specific funding for services to themselves. They will fear states will not give them the same funding priority they had by having a separate categorical federal program. Those receiving direct federal grants (e.g., localities, community action agencies, community health centers, and other non-profit groups) will oppose this proposal since they would fear that other entities might receive grant funds that they themselves now have. Hill reaction will be mixed given the various committee jurisdictions covering the proposed programs to be consolidated.

Elementary, Secondary Grants Consolidation

	1981	1982
Proposed Savings	—	1,258

The proposal is to consolidate the purpose of all or part of 57 separate federal elementary and secondary education programs — one-third of all Education Department programs — into two "block grant" programs, which would be funded in FY '82 at 80 percent of the level represented by the sum of the components in FY '81.

Accompanying this consolidation, and offsetting the reduction in federal funding, would be a great increase in state/local flexibility with respect to the uses of the federal funds, and slicing away of numerous regulations and requirements that create costs for state and local education agencies.

In particular, it is planned to seek changes in the Education for Handicapped Children Act (P.L. 94-142) and in Section 504 of the Rehabilitation Act of 1973, that would narrow the group of handicapped persons (with respect to whom federal requirements are imposed and funds made available) to those with severe disabilities and to limit the "related services" that must provided.

Residual programs not included in either of the two block grants are of three kinds:

1. Several large programs are (e.g., Impact Aid, Vocational Education) where separate legislative initatives are planned.

2. Programs and activities that are not suitable to inclusion in a state or local block grant. These include Indian education, assistance to the Virgin Islands, evaluation activities, media services, "deaf-blind" centers, educational research and dissemination, and the gathering of statistics.

3. Programs and activities not fundamentally related to elementary and secondary education, such as rehabilitation services and all of the postsecondary programs.

Probable Reaction: This proposal sketches a nearly-complete overhaul of federal elementary and secondary education policy. It will be popular with many, especially those who believe that the federal role is to supply resources, not to specify what must be done with those resources. It will also appeal to school boards and others now laboring under the burden of detailed regulations, service requirements, maintenance-of-effort clauses, and the like.

Disapproval can be expected from each separate group or interest that now has one or more separate programs it identifies as "its own" and that under this proposal would have to compete for resources with other groups at the state or local level. The proposal would be characterized by opponents at a backing-away from the "historic" federal responsibility for assisting each group and meeting each need separately. Civil rights groups can also be expected to be disquieted.

The reception will further be dampened by the reduction in aggregate funding for a set of activities that have experienced little or no increase (hence a decrease in real terms) in the past two years.

The proposal will also be analogical to President Nixon's 1973 proposal for "special revenue sharing" in the field of education, which met a swift death in the 93rd Congress, and to President Ford's 1976 consolidation proposal, which fared no better.

Student Loans And Pell Grants

	1981	1982
Proposed Savings	-89	-914

Current Program: The Guaranteed Student Loan (GSLs) program facilitates borrowing from private lenders by graduate and undergraduate students (and their parents).

The National Direct Student Loan (NDSL) program provides participating institutions with capital contributions for student loan funds which the institution must match with 10 percent from non-federal funds. These institutional loan funds then make 4 percent loans to needy tested students.

The Pell Grant (formerly BEOG) program is authorized, under the new law, to provide a maximum award of $1,900 in 1981 and $2,100 in 1982. The percentage of educational costs covered increases from 50 to 60 percent when the maximum award reaches $2,100 in 1982. The grant a student receives takes into account the family income less specified deductions and a student's educational costs.

Potential Change:

- Provide student GSLs only for need remaining after other sources of aid counted, eliminate the in-school interest subsidy, and charge market rate on parent loans.
- Reduce the funding of NDSL Federal Capital Contributions by 25 percent per year. This approach will phase-out new federal capital in this program in four years. However, schools' revolving funds totaling approximately $3.5 billion would continue to provide loans to eligible students.
- Impose a $25,000 income limiation for participation in the Pell Grant program. Limiting participation in this program to families with the median national income or less (projected to 1981 this would be approximately $25,000) would reduce the number of participants by an estimated 286,000 in both 1981 and 1982.

Probable Reaction: College costs are a major concern to middle-income families, who would react negatively to any reduction in federal support for higher education. Higher education institutions whose students receive substantial amounts of federal student assistance benefits would also protest strongly.

Rural Electrification Administration

	1981	1982
Proposed Savings	699	1,945

Current Program: The Rural Electrification Administration of USDA makes direct and guaranteed loans to advance the construction and operation of electric and telephone utilities in rural areas. Direct loans are made on highly favorable terms. Since the mid-70s, the REA has increasingly relied on the Federal Financing Bank as the originator of many of these guaranteed loans.

Potential Change: The savings projected above would result from a major retrenchment in REA activity designed to (1) increase the reliance of REA borrowers on private sources of capital and (2) focus REA activity on those areas truly requiring federal support.

The changes are:

- Effective April 1, 1981, stopping further FFB originations of REA-guaranteed loans.
- Elimination of 2 percent loans for electrification and telephone construction programs.
- Elimination of all loans for power supply purchases. The REA was intended to facilitate utility construction, not to provide operating subsidies.
- A 25 percent reduction in the principal amount of direct loans disbursed annually.

This last proposal, as well as all the others, is based on the premise that the REA has largely accomplished its purpose — to provide the investment capital necessary to construct electric and telephone infrastructure nationwide. The bulk of lending is now for

power

power generation and system upgrading, functions that should be borne by system users.

In the absence of restraint, REA would continue to expand the reliance of rural utility companies on federally provided and sponsored credit.

Probable Reaction: The affected utilities, of course, will not be pleased to have to bear financing costs more reasonably related to the true cost of funds. The need for short-term rate hikes to support private borrowing market rates will also offend customer of REA-financed utilities. Congressional delegations from the regions in which these utilities operate will be sensitive to these concerns.

Export-Import Bank

	1981	1982
Proposed Savings	155	560

Current Program: The Export-Import Bank provides a wide range of credit support activities on behalf of sales of American goods and services ovverseas.

Potential Change: The savings estimate . . . reflects three major changes in the bank's level of operations:

- A 25 percent reduction in new direct loan originations below levels planned for the five-year period;
- A prohibition against interest subsidies in guaranteed loan transactions.
- Elimination of discount loans.

Probable Reaction: The Boeing Corp., which consumes the lion's share of the 42 percent of Export-Import Bank direct loans that support aircraft sales, might lose sales in those instances (roughly 20-30 percent of Bank/Boeing activity) where Boeing comes head to head with subsidized foreign producers. Other major bank users, among them many Business Roundtable members, will be forced to find buyers with access to private credit. While the opinion of the business community is divided on the Export-Import Bank due to the heavy emphasis it places on overseas aircraft sales and construction projects, both present and potential users would feel constrained to object strenuously.

Farmers Home Administration

	1981	1982
Proposed Savings	30	105

Current Program: As the agency's title suggests, the Farmers Home Administration (FmHA) was started as a means of providing credit assistance for family farm operations and the construction of housing in rural areas, which were left after the rash of bank failures in the early 1930s with severe credit shortages.

Since that time, FmHA has been expanded to the point where it duplicates virtually every other federal lending and lending assistance effort. Through three major funds, the FmHA now makes loans for housing, community dvelopment, farm operation, hospital construction, sewer and waste treatment facilities, ad infinitum. In FY 1981, in addition to far-flung loan guarantee operations, FmHA will make $14 billion in direct loans from these three funds.

Proposed Changes: The savings estimates contemplate a 25 percent across-the-board reduction in new direct lending by the agency.

Probable Reaction: The FmHA is a favorite means of dispensing largesse to constituents in rural areas, and congressional offices are heavily involved in the process of securing FmHA grants and loans for local farms, businesses and government subdivisions. While funding reductions would not prohibit congressionally assisted grantsmanship, they would severely restrict its scope, particularly if the reductions were achieved, as suggested above, by targeting remaining funds to lowest-income borrowers.

Can Thatcherism Survive British Slump?

By WILLIAM BORDERS

LONDON

WHEN Prime Minister Margaret Thatcher discusses the very serious economic recession that Britain is experiencing, she often employs homely metaphors to explain her conviction that better times must follow, if only the course is held true.

"It's like a nurse looking after a patient," she said recently, in a characteristic explanation of why the Government thinks it has to be tough and austere in the face of soaring unemployment and industrial decline.

"Which is the better nurse," the Prime Minister asked, "the one who smothers the patient with sympathy and says, 'Never mind, dear, there, there, lie back and I'll look after you,' or the nurse who says, 'Now come on, shake out of it. It's time you put your feet to the ground and took a few steps. Now get back and take a few more tomorrow.' "

As no one in Britain needs to be told, Mrs. Thatcher is the firm nurse in that metaphor. But her political problem, of course, is that the patient can always get another nurse.

As this particular nurse nears the midpoint in her tenure at 10 Downing Street, the British economy is in worse shape, by most measures, than it has been in years. Unemployment stands at nearly 9 percent and is increasing so relentlessly that The Sunday Times began publishing a weekly listing, headlined "Jobless Britain," of factories that have closed and the number of jobs were lost at each. The number unemployed, now well over two million, increased by 900,000 in 1980.

Industrial production has been declining more sharply than at any time in years, and inflation is 15 percent. That is lower than the peak reached last summer but still above the 10 percent when Mrs. Thatcher took office 21 months ago.

Millions of people, including the newly unemployed and their families, feel directly aggrieved by the Conservative Government, and the party — and Mrs. Thatcher in particular — are slipping steadily behind the opposition Labor Party in the public opinion polls.

"Maggie, Maggie, Maggie — out, out, out," the

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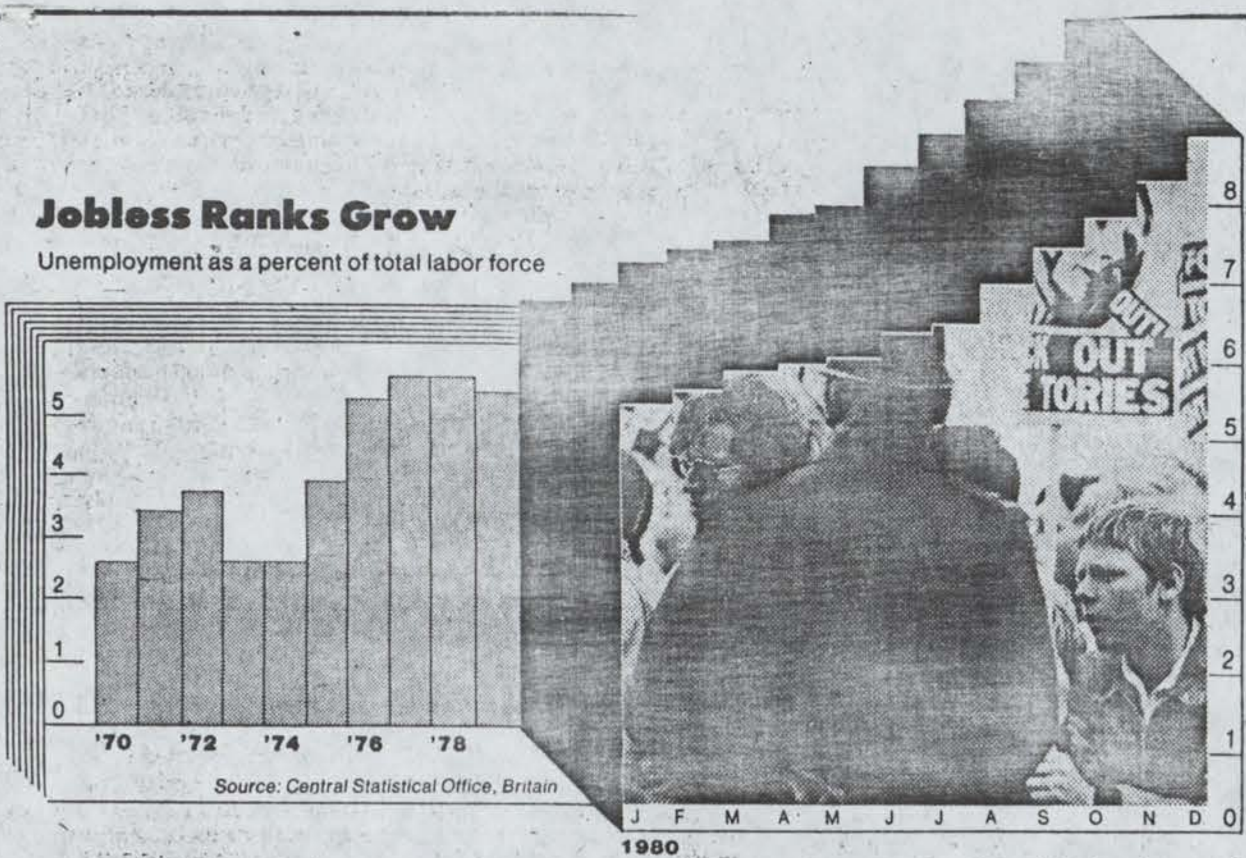

Can Thatcherism Survive?

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marchers chanted at a huge unemployment protest in Liverpool one cold day last fall. Within the Conservative Party, and even within the Cabinet, there is growing concern that that could become a rallying cry for the whole country.

With its comfortable majority in the House of Commons, the Conservative Government will not have to call an election before 1984. But that date, which looked so far away at the beginning of Prime Minister Thatcher's term, looks closer now. As one of her advisers said, "It could be disastrous if our policies haven't begun to show some good by the time we have to go to the voters."

Even by some within her own party, the Prime Minister is increasingly being urged to relent a bit on her strict austerity program and to increase — instead of cut — public spending, step up help for ailing industry and rely less on firm monetarism as the ultimate weapon against inflation.

To Mrs. Thatcher's great irritation, even former Prime Minister Edward Heath, also a Conservative, has described her economic policy as "catastrophic." Nonetheless, every time she is asked about it, she replies like the firm nurse.

"Our goal must be to bring down inflation and to build a realistically strong economy in which productive, well-based industry can prosper," she said recently. "For years, we have been paying ourselves more than we produced. This must stop."

The economic pressures of the past year have forced some companies to become leaner and more efficient and some labor unions to moderate their demands. Defenders of the Government say this will happen more and more, and the result will be a stronger, more competitive Britain.

They also like to point to the one bright spot on the economic horizon: the steadily swelling flow of oil from the North Sea. With current production of 1.7 million barrels a day, exceeding such giants as Indonesia and Kuwait, Britain has become self-sufficient in oil, saving billions in import bills.

"It gives us a cushion against shortages and supply fluctuations, not to mention a great income to apply elsewhere in the economy," said an oil executive here.

But even that good news has a dark side. The oil production has been a major factor in the appreciation of sterling, which is now trading at a level 50 percent higher than in 1976. This has had a devastating effect on exporters, making their goods more expensive abroad.

Such traditional exporting industries as textiles have been particularly hard hit, and so has the automobile business, which suffers from competition with cheaper imports. Well over half the cars now sold in Britain are foreign made.

Sir Michael Edwardes, the chairman of BL Ltd., the automobile company that used to be called British Leyland, expressed a widely held view among industrialists when he declared in exasperation that, if the Government could not figure out a way to keep the oil from hurting big business, it should "leave the bloody stuff in the ground." □