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TO IMMEDIATE FCO

TELEGRAM NO 385 OF 5 FEBRUARY

AND TO PRIORITY PARIS, BONN, UKDEL NATO, UKREP BRUSSELS,

KUALA LUMPUR (FOR PRIVATE SECRETARY)

UNITED STATES: BUDGET FOR FY83

1. PRESIDENT REAGAN WILL ON MONDAY 8 FEBRUARY PRESENT HIS FY83 BUDGET TO THE CONGRESS. WE HAVE OBTAINED A COPY OF HIS PROPOSALS IN ADVANCE. THESE ARE EMBARGOED UNTIL 12 NOON LOCAL TIME AND SHOULD NOT BE MADE PUBLIC BEFORE THEN. PROJECTIONS FOR THE BUDGET TOTALS AND THE DEFICIT UNTIL 1985 ARE AS FOLLOWS:-

	1982	1983	1984	1985
	(BILLIONS OF DOLLARS)			
RECEIPTS	626.8	666.1	723.0	796.6
OUTLAYS	725.3	757.6	805.9	868.5
DEFICIT	- 98.6	- 91.5	- 82.9	- 71.9

THE BUDGET DOCUMENTS ALSO INDICATE THE SENSITIVITY OF THE DEFICIT PROJECTIONS TO VARIOUS CHANGES IN ECONOMIC ASSUMPTIONS. THIS ANALYSIS INCLUDES, FOR EXAMPLE, A QUOTE HIGHER GROWTH/LOWER INFLATION UNQUOTE SCENARIO WHICH LEADS TO A BALANCE BY 1986, AND A QUOTE LOWER GROWTH/HIGHER INFLATION UNQUOTE SCENARIO WHICH LEADS TO DEFICITS RISING TO DOLLARS 131 BILLION IN THAT YEAR.

2. THE MAIN ECONOMIC ASSUMPTIONS ARE AS FOLLOWS:-
(CALENDAR YEARS)

	1981	1982	1983	1987
NOMINAL GNP (PERCENT INCREASE)	11.3	8.1	11.5	9.0
GNP (CONSTANT 1972) DOLLARS (PERCENT INCREASE)	2.0	0.2	5.2	4.3
CONSUMER PRICE INDEX (PERCENT INCREASE)	10.3	7.3	6.0	4.5
UNEMPLOYMENT RATE (PERCENT)	7.6	8.9	7.9	5.3
INTEREST RATE (91 DAY T.BILL) (PERCENT)	14.1	11.7	10.5	5.5

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/ 3. IN TOTAL

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3. IN TOTAL, DOLLARS 55.9 BILLION IN BUDGET REDUCTION MEASURES ARE PROPOSED FOR FY83, CONSISTING OF DOLLARS 11.7 BILLION IN SAVINGS IN ENTITLEMENTS EXPENDITURE, DOLLARS 2.5 BILLION IN USER FEE INCREASES, DOLLARS 20.3 BILLION IN WHAT ARE DESCRIBED AS QUOTE MANAGEMENT INITIATIVES UNQUOTE, DOLLARS 14.2 BILLION IN SAVINGS ON DISCRETIONARY AND OTHER PROGRAMMES, AND DOLLARS 7.2 BILLION IN REVENUE GAINS FROM TAX REVISIONS. THE PHRASE QUOTE MANAGEMENT INITIATIVES UNQUOTE INCLUDES SUCH ITEMS AS AN AGGRESSIVE CAMPAIGN TO COLLECT DELINQUENT DEBTS OWED TO THE FEDERAL GOVERNMENT, A REDUCTION OF A FURTHER 75,000 CIVIL FEDERAL EMPLOYEES IN THE PERIOD 1985-87 AND RESTRAINT ON THEIR PAY INCREASES, THE SALE OF FEDERAL PROPERTY, THE ACCELERATION OF LEASING ON THE OUTER CONTINENTAL SHELF, AND IMPROVED TAX COLLECTION AND ENFORCEMENT.

4. REDUCTIONS IN MEDICAL ENTITLEMENTS ACCOUNTS FOR DOLLARS 5.1 BILLION OF THE ENTITLEMENTS SAVINGS OF DOLLARS 11.7 BILLION, AND REDUCTIONS IN CASH ASSISTANCE AND NUTRITION ANOTHER DOLLARS 4.6 BILLION. THE DOLLARS 14.2 BILLION OF SAVINGS IN DISCRETIONARY PROGRAMMES ARE WIDELY SCATTERED.

5. THE TOTAL OBLIGATIONAL AUTHORITY FOR DEFENCE SPENDING IS EXPECTED TO BE DOLLARS 258 BILLION IN FY83 AND DEFENCE OUTLAYS OF DOLLARS 215.9 BILLION ARE PROPOSED. THE AVERAGE ANNUAL REAL INCREASE IN DEFENSE SPENDING FROM 1981 TO 1987 IS PUT AT 7.9 PER CENT, ENTITLEMENT EXPENDITURE 1.5 PER CENT AND OTHER CIVIL PROGRAMMES MINUS 7.6 PER CENT.

6. ON FIRST SIGHT IT APPEARS THAT THE ADMINISTRATION IS RELYING ON THE SUCCESS OF MANAGEMENT INITIATIVES FOR A SUBSTANTIAL PART OF THE SUCCESS OF ITS FY83 BUDGET STRATEGY. THIS TACTIC COULD BE INTENDED TO AVOID HAVING TO OBTAIN SPECIFIC LEGISLATION, WHICH WOULD NEED CONGRESSIONAL APPROVAL IN ORDER TO ACHIEVE CUTS IN EXPENDITURE. IT COULD ALSO MEAN THAT THE BOTTOM OF THE BARREL HAS BEEN REACHED IN CANVASSING FOR CANDIDATES FOR POLICY CUTS FROM SPENDING DEPARTMENTS.

7. RECENT PRESS COMMENT HAS REMAINED SCEPTICAL ABOUT WHETHER PRESIDENT REAGAN'S FY83 BUDGET PROPOSALS, AS OUTLINED BY THE PRESIDENT IN HIS STATE OF THE UNION ADDRESS ON 26 JANUARY, WILL BE SUFFICIENT TO RELIEVE THE PRESSURES ON FINANCIAL MARKETS AND

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INTEREST RATES ARISING FROM HIGH FEDERAL BUDGET DEFICITS. THERE IS ALSO DOUBT ABOUT WHETHER ALL THE FY83 BUDGET PROPOSALS WILL GET AS SMOOTH A RIDE IN CONGRESS AS THOSE FOR FY82, ESPECIALLY THOSE FOR REDUCING PUBLIC EXPENDITURE ON ENTITLEMENT PROGRAMMES. REAGAN'S PROPOSALS FOR A NET TRANSFER OF FUNCTIONS FROM THE FEDERAL GOVERNMENT TO THE INDIVIDUAL STATES HAS SO FAR FAILED TO DIVERT ATTENTION FROM THE BASIC CONDITION OF THE US ECONOMY, WITH UNEMPLOYMENT AT 8.5 PERCENT AND INTEREST RATES REMAINING PERSISTENTLY HIGH. COMMENTATORS MAY ALSO FOCUS ATTENTION ON THE LESS ATTRACTIVE SCENARIOS MENTIONED IN PARAGRAPH 1 ABOVE AS WELL AS ON THE ADMINISTRATION'S CENTRAL PROJECTIONS.

8. FURTHER COMMENTS ON THE FY83 BUDGET AND AN ASSESSMENT OF INITIAL CONGRESSIONAL AND MEDIA REACTIONS WILL FOLLOW BY SEPARATE TELEGRAM.

9. FCO PLEASE ADVANCE TO PS/SIR KENNETH COUZENS AND BOTTRILL (TREASURY), AND WATSON (BANK OF ENGLAND).

HENDERSON

FINANCIAL
NAD

[ADVANCED AS REQUESTED]