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Special Adviser

6 September 1982

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Prime Minister
MCS 14/9

Dear Mr Scholar

USA ECONOMY

Mr Sterling thought that the Prime Minister may be interested, if she has not seen it already, in the attached report from Business Week on the "built in deficit" in the USA economy.

Yours
Kevin Tomlin

KEVIN TOMLIN
PS/Mr Sterling

No 8/9
Have R
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Have I ack'd?
MCS 17/9

CF
Got anywhere suitable for this?
J.

USD

30 September 1982

Thank you for your letter of 6 September with which you enclosed a copy of a report from Business Week, which Mr. Sterling thought the Prime Minister would be interested to read.

She was indeed interested to see this and has asked me to pass her thanks on to Mr. Sterling.

M. C. SCHOLAR

Kevin Tomlin, Esq.,
Department of Industry.

THE BUILT-IN DEFICIT

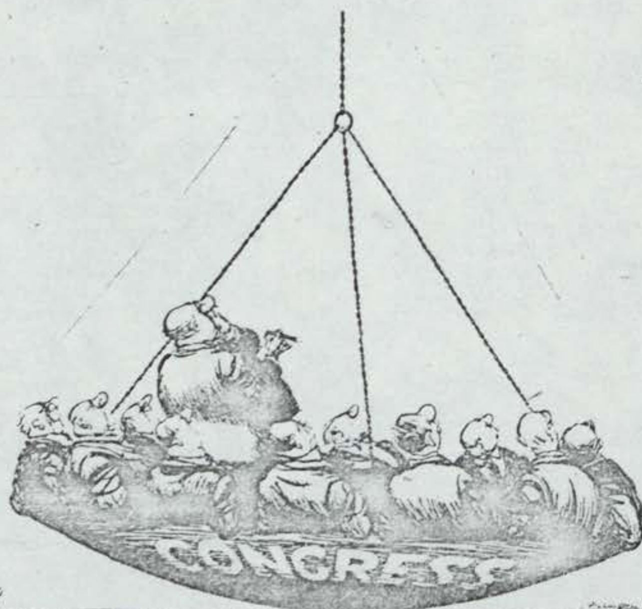
What it is doing to the economy | Why federal spending outpaces revenues | The trouble is Congress

Deficits are hardly new in the U. S. economy. There have been 10 in the past decade, 19 in the past 20 years, 32 since World War II, and 45 since the New Deal swept the government in 1932. But now, for the first time in its history, the U. S. economy is suffering from a built-in deficit, one that will remain astronomically high even if no new spending programs or tax reductions are enacted. And the shortfalls will stay unprecedentedly huge even if there is a solid recovery. From 1982 to 1985 the U. S. will add almost $500 billion to the national debt, more than it had in the preceding 30 years.

Launching a successful attack on the structural deficit is the most critical political task of this decade. This deficit has taken root despite 10 years of lip service to a balanced budget; despite passage of the Budget Control Act of 1974, which was supposed to get expenditures into line with receipts; and despite the revolutionary results of the 1980 election, which seemed to mandate a shrinking role for the government.

Whether the U. S. will be able to break the shackles of the built-in deficit—after a decade in which the moves that were supposed to balance the budget have only succeeded in creating a bigger imbalance—will depend on whether executives, Washington policymakers, and the American public have a clear understanding of the true origins of the deficit and its debilitating economic effects. It is now apparent that Washington's failure to capitalize on strong public sentiment in favor of scaled-down government following the 1980 Presidential election was a monumental political malfunction, one for which the nation is paying a high price today—the most miserable and baffling economic environment that business has seen since the Depression:

- Business sales are stagnant. Whatever their long-run inflationary consequences, deficits used to help spur economic growth. Now the built-in deficit is a major barrier to economic recovery and to a return to long-term prosperity.



'ALL BALANCED AT THIS END, MR. PRESIDENT. HOW'S EVERYTHING AT YOUR END?'

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- Real interest rates are at record levels. Reduced inflation used to usher in lower interest rates, particularly on long-term bonds. Market rates have, in fact, declined somewhat in the past year. But inflation has fallen much faster, leaving real interest rates, particularly long-term ones, at record levels. And the Federal Reserve cannot do anything about it. Until now easy-money policies traditionally helped bring down interest rates. Today, at almost any sign of ease by the Fed, rates shoot up. Investors interpret a move toward ease as a sign that the Fed has embarked on an inflationary policy of fast money growth to finance the deficit.
- The U. S. is deindustrializing. Cuts in corporate taxes used to tilt the economy away from consumption and toward investment. But the Economic Recovery Tax Act of 1981 has had the opposite effect. The U. S. is becoming more dependent than ever on consumer spending. The nation's industrial plant and equipment are deteriorating, and more companies are being forced to sell off or close down businesses in basic industries.
- Export markets are shrinking. The reduction in inflation that the U. S. has experienced should have improved international competitiveness and spurred exports. Instead, the built-in deficit is keeping U. S. interest rates high and the dollar strong, offsetting the competitive gains from lower inflation. As a result, the U. S. is expected to run huge trade deficits into the mid-1980s.
- Uncertainty over economic policy is rife. In the middle of a severe recession, neither economists nor politicians would have advised raising taxes or cutting spending. Now, however, many economists are recommending just that. And the politics of deficits have become so absurd that Congress, barely one year after passing the largest tax cut in history, has done an about-face and is proposing the biggest tax increase in history.

It is not so much the 1982 deficit that is wrecking the economy; it is the prospect of huge deficits out to 1985 or even 1987. The U. S. has lost long-term control over the balance between expenditures and revenues. Spending as a percent of gross national product will

av[illegible]ge an unprecedentedly high 23% from now until 1985, while revenues' percentage will decline steadily to less than 20%. In the past two decades, spending averaged 20% and revenues 19%. As a percent of GNP, the deficit will rise to a historic high of 4% the coming fiscal year and next before gradually declining to 2% by 1985. In past recoveries, deficits dropped sharply to well below 1% of GNP in just a few years.

In dollars, the deficits from fiscal 1982 through 1985 are staggering. According to the Office of Management & Budget's midsession review, released on July 30, the deficit will jump from this year's $109 billion to $115 billion in fiscal 1983 before falling to $74 billion in fiscal 1985. That forecast, however, was the cause of a bitter internal debate within the Administration—a debate many observers believe was the reason Chairman Murray L. Weidenbaum and member Jerry Jordan of the Council of Economic Advisers recently resigned. And OMB Director David A. Stockman conceded on Aug. 3 in testimony before Congress that his office's 1983 estimate could easily be understated by $20 billion.

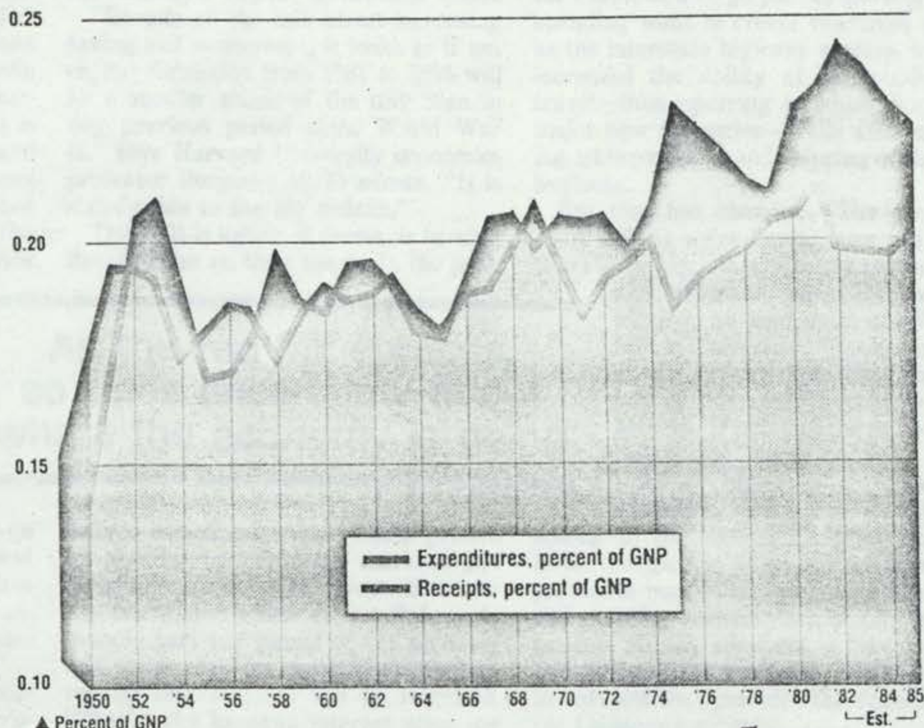
Even before Stockman's public concession, most observers believed that the best estimates of the deficit are not those of the Administration, but those made by the Congressional Budget Office. CBO Director Alice M. Rivlin has estimated that the deficit for 1982 would be approximately $125 billion and that it would stay within a range of $140 billion to $160 billion through 1985. Federal Reserve Board Chairman Paul A. Volcker concurs.

'Not the same kick'

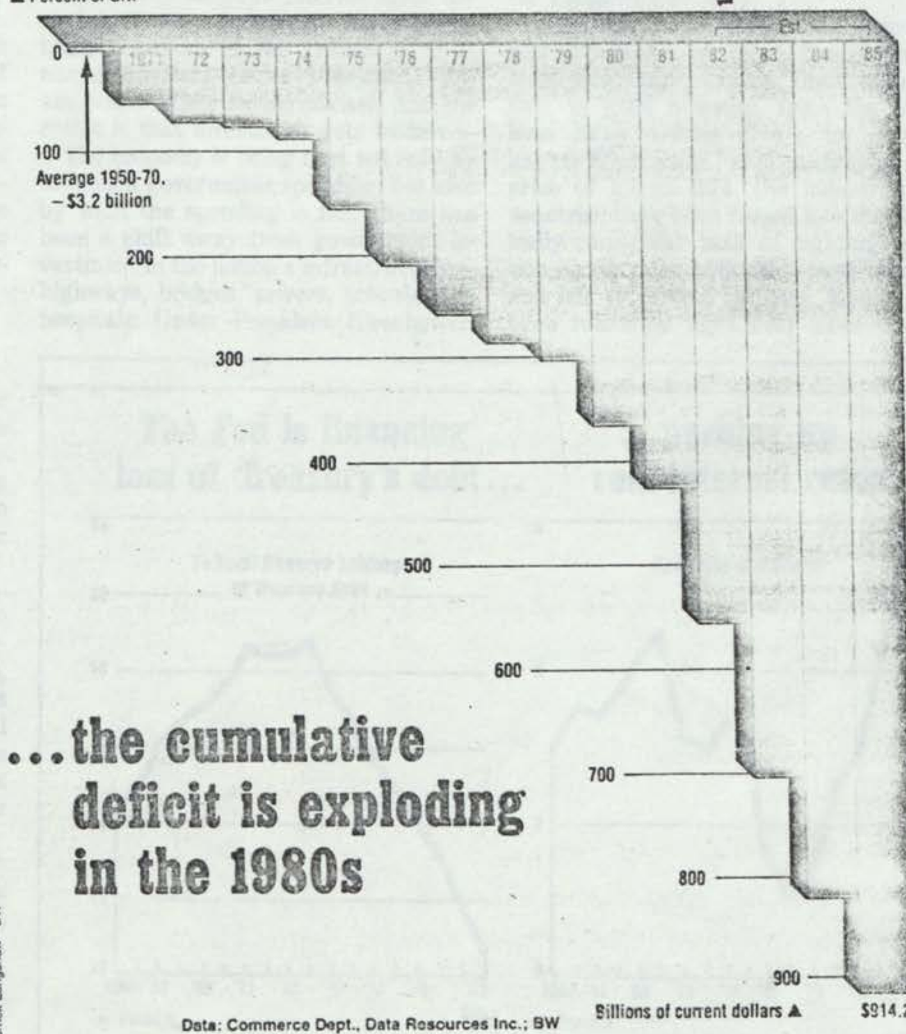
The change in the short-run impact of budget deficits is one of the most surprising features of the new economic environment. Ever since Congress passed the deficit-creating tax cut in the summer of 1981, forecasters in and out of government have been predicting economic recovery. But company order books have become thinner and thinner. "Deficits do not have the same expansionary kick they had back in the '40s, '50s, or '60s," concedes the first U.S. Nobel laureate in economic science, Paul A. Samuelson of the Massachusetts Institute of Technology, a leading Keynesian.

In an economy in which deficits have become chronic, Samuelson explains, the stimulative effect of this year's estimated $125 billion deficit is muted. As the deficit estimates escalate, uncertainty about future economic policy increases, and this gets reflected in interest rates. Therefore, Samuelson says, "you lose in

With federal receipts stuck below expenditures...



...the cumulative deficit is exploding in the 1980s



Data: Commerce Dept., Data Resources Inc.; BW

Derrick Langshaw—BW

action, slowing economic growth. But the politicians have tried to cushion the impact of that slow growth with a constantly widening safety net of social programs that has pushed deficits up as a proportion of GNP.

In the U. S., the clash between tight monetary policy and loose fiscal policy has become particularly intense this year. "When related to potential GNP, the fiscal 1983 budget is among the two or three most expansive in the postwar period," calculates Goldman Sachs's Wenglowski. In that situation, the Fed can either accommodate the large deficits by boosting its purchases of government securities—thus increasing money and credit—or it can allow those securities to hit the private markets and, therefore, keep money and credit growth within its targets. Up to this point the Fed has clearly chosen the latter course (chart). The result has been the highest real interest rates in history and the sharpest recession since World War II.

Fed Chairman Volcker maintains that a tighter fiscal policy is a precondition to sustained ease on the monetary side. "A credibly firmer budgetary posture would permit us a degree of greater flexibility. Specifically, by dampening concern about a resurgence of inflation or credit-market pressures, fiscal restraint also lessens fears that short-run increases in the money supply might presage a continuing inflationary monetization of the debt," Volcker contends.

But changing the fiscal-monetary mix that forces monetary policy to carry the fight against inflation might be more difficult to achieve than even the Fed chairman may care to admit. The combination of tight money and easy fiscal policy has been intellectually justified by economist Robert Mundell of Columbia University. In the early 1970s, Mundell argued that the mix was just what is needed to fight inflation and stimulate economic growth.

In his view, the key to growth is holding down inflation and eliminating the distortions and inefficiencies it creates in the markets. If government can maintain a tight money policy and guarantee the value of its currency, it will break inflationary expectations, he contended. A loose fiscal policy, he added, is no real danger, since lower taxes mean greater incentives, which will lead to accelerating real economic growth and, therefore, more savings in the private sector.

Mundell's theory was adopted to varying degrees in the major industrial countries because it provided a justification for what politicians really wanted to do anyway to fight the inflation caused by OPEC. So while governments—including Washington—ran up big deficits, they instituted restrictive monetary policies to damp inflation.

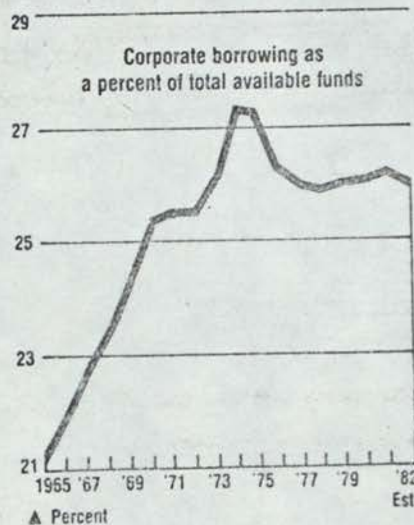
Indeed, in the U. S., Mundell's theory became the linchpin of the supply siders, who went one step further and argued that cutting taxes would stimulate economic growth so quickly that the deficit would fast disappear. Clearly, that supply-side promise has not materialized. And although the Fed may have eased its tight grip on credit conditions in recent weeks, the structural deficit means that monetary policy still has to carry the burden of containing inflation.

The No. 1 villain: Runaway entitlements

The structural deficit was made in Washington, particularly on Capitol Hill. It is the end product of 20 years of economic myopia, political greed, and legislative recklessness. Its origins lie in the thinking that characterized the go-go 1960s, when Washington operated on three highly optimistic premises: that economic growth would continue strong enough to make all things possible, that inflation would continue to push an unprotesting public into higher and higher tax brackets, and that the U. S. was rich enough to redistribute income through a series of entitlement programs without doing any damage to the nation's productive or financial capacity.

But the harsh lesson of the 1970s, which Congress still chooses to ignore, is that none of these premises was valid in the longer run. Economic growth slowed, the public revolted against being milked of tax dollars by bracket creep, and political chicanery caused the cost of income redistribution through entitlement programs to grow beyond any nation's financial capacity (page 91). In addition, the U. S. public recognized that the decline in defense spending's share of GNP—with the ratio tilted to finance the growth of social programs—left the country dangerously vulnerable.

In the second half of the 1970s, inflation made the ultimate consequences of the politicians' mistakes difficult to see. "The structural deficit is largely the product of the disinflation process," says OMB Director David A. Stockman. "The spending programs were built up during the '60s and '70s, and temporarily the surge in inflation financed the spending commitments that had built up without apparent strain. The problem is that the inflationary source of financing was unsustainable. The disinflation process unmasked the structural deficit." Adds Van Ooms, chief economist for the House Budget Committee: "Many pro-



Data: Data Resources Inc., BW estimates

Arlene Cassidy—BW

grams were greatly expanded during the '60s when it appeared that strong economic growth would go on forever."

The popular view is still that huge deficits are caused largely by pork-barrel legislation. It is true that legislators, sometimes with executive branch urging, waste a lot of money supporting each other's favorite water projects, farm-price supports, shipbuilding subsidies, or job-training programs. But all legislation of this kind is so-called discretionary spending, which is both a relatively small part of the budget (19.5% in fiscal 1982) and relatively easy to control. The Administration, in fact, has had its greatest successes in cutting just this sort of expenditure.

What has become increasingly clear in recent years, especially since Reagan took office, is that the really big bucks are in the "entitlement programs." By definition, an entitlement is a federal benefit to which any qualified citizen has a right by law, and the money for such outlays does not have to be appropriated each year. These programs just grow automatically as demand for the benefits grows. Entitlements—including Social Security, medicare, medicaid, aid to families with dependent children, civil service pensions, and disability insurance—accounted for 48% of the budget in 1981.

The untouchables

In Washington, entitlement programs are generally regarded as the major part of the budget's "uncontrollable spending" portion. But the only truly uncontrollable budget cost is interest, since the government must pay its debt. What makes entitlement spending uncontrollable is that the programs' constituencies are so large and politically powerful that until last year politicians have been almost unwilling even to discuss touching them seriously.

The history of entitlement programs can be dated from the New Deal, when the biggest, most costly, and most politically potent of them—Social Security—was begun. The Social Security system made it politically acceptable to believe that the government had a responsibility for maintaining some level of well-being for its citizens. That idea was greatly expanded in President Johnson's Great Society as such programs as medicare and Head Start were adopted to attempt to deal with poverty and racial discrimination. And the big spur to entitlements came in the last decade, when eligibility for—and benefits from—almost all programs were vastly increased. As William Greider notes in his forthcoming book, *The Education of David Stockman and Other Americans*: "[Stockman's complaint has been that] liberal politics in its later stages had lost its ability to judge claims and so yielded to all of them . . . . As Stockman saw it, this process did not ameliorate social inequities; it created new ones by yielding to powerful interest groups."

Stockman: Inflation temporarily financed spending programs of the '60s and '70s.

It is generally accepted that the biggest factor making the budget deficit unmanageable was the 1972 move boosting Social Security benefits 20% and then indexing the system to increases in the consumer price index. That event vividly demonstrates the devastating effect of playing politics with entitlements, something Washington has done over and over again. The powerful chairman of the House Ways & Means Committee at that time, Wilbur Mills, believed that a big increase in Social Security benefits would greatly support his Presidential bid in the 1972 elections. As it turned out, nothing could help Mills, but President Nixon, who initially opposed the benefits increase, changed his mind as the election drew near and went along with the move.

Congress has played politics with spending while counting on the Fed to control inflation

After Nixon's victory, however, House Republicans initiated the idea of indexing Social Security, in the hope that the politicization of benefit increases could be eliminated. The idea was that if levels were adjusted automatically, politicians could not curry favor with the voters by bidding up benefits. Just how vain that hope has turned out to be emerged clearly in the past year, as Congress and the White House jockeyed over how to tackle Social Security's runaway costs.

Everyone agrees that something must be done to stem the rise in the program's spending, which went up from $64 billion in 1975 to $155 billion this year. By 1990 the cost of the Social Security system will double to $310 billion. But when Reagan proposed in May, 1981, that costs be lowered by reducing early retirement benefits, cutting welfare payments, and raising the amount of money retirees could earn so that their Social Security benefits could be trimmed, the Senate, in a nonbinding resolution, rejected key elements of the plan by a 96-to-0 vote. And that fall, Reagan turned down a bipartisan Senate plan sponsored by Senator Pete V. Domenici (R-N. M.) to trim Social Security by capping cost-of-living adjustments.

While Social Security is by far the biggest, it is not the only major entitlement program where costs are running away. Almost all of them, including medicare and medicaid, were indexed in the '60s and '70s. With inflation soaring, the costs of such indexed programs rose by staggering amounts. From 1975 to 1982 the tab for medicare jumped $15 billion, to $46 billion, and the medicaid bill rose $10 billion, to $17 billion.

And indexing is not the only problem. In keeping with the philosophy that growth and inflation could finance everything, Washington also encouraged states to raise benefits and expand eligibility for many programs. The cost of aid to families with dependent children has soared, largely because the number of people becoming eligible for assistance increased enormously. Similarly, while food stamps are not legally an entitlement program, they have become a quasi-entitlement, because Congress until last year automatically boosted the amount of money available as demand rose. And it rose dramatically in the '70s when President Carter substantially increased benefits. From 1975 through fiscal 1982, the cost of the program will have doubled, from $4.6 billion to an estimated $10.3 billion.

Demographic changes, too, are driving up expenses. As the elderly portion of the population grows larger, the costs of Social Security, medicare, and medicaid are pushed higher and higher. Veterans' pensions have become dramatically more expensive, and though their costs will level off, veterans' medical benefits will continue to go up sharply, growing by about 30% by 1985. Civil service pensions increased to $20 billion in 1982, almost three times their 1975 level, and they are

expected to rise $27 billion by 1985.

The spending side cannot be blamed entirely for the built-in deficit. The enormous tax cuts enacted last year are slashing revenues and will continue to do so in the years ahead, at the same time that disinflation will depress the government's income. Unless it is changed, the Christmas-tree tax bill that Congress finally passed will, by 1986, increase the federal revenue loss by an estimated $42 billion more than the Administration's original proposal. Reagan's plan would have cut receipts by $225 billion; the congressional bill raised that figure to $267 billion. If the $99 billion tax increase recently proposed by Senator Robert J. Dole (R-Kan.) is accepted, however, the tax loss by 1986 will drop to an estimated $209 billion.

Cures for congressional paralysis

Because the built-in deficit is so large and the pressures from Congress to maintain programs are so strong, stemming the red ink will not be easy. Until now all the best-intended strategies—such as capping revenues to cap spending (the Reagan ploy), impounding government funds (the Nixon ploy), and improving budgetary control procedures (the congressional ploy)—have failed miserably. What is even more disheartening is that Congress did not manage to close the budget gap when the shortfall was minuscule, compared with the deficits that the U. S. will be facing in the years ahead.

Everyone recognizes that it will be impossible to put all the deficit-closing eggs in one basket. Instead, the realistic choice is some compromise among a number of menus attractive to political coalitions that have substantial constituencies. These alternatives are:

- The pure-growth option. Advocates believe that the supply-side tax cuts will eventually work and the economy will stage a vigorous recovery. Since that recovery will wipe out the deficit, they

Red ink engulfs Europe, too

The U. S. is not the only country wrestling with swelling structural deficits. Expanding deficit spending to meet everything from a rising tide o. unemployment claims—10.6 million are now jobless in Europe—to 1981's $34 million loss on the Concorde is a way of life on the other side of the Atlantic as well.

Until now the U. S. has done better in the budget sweepstakes than have other industrialized countries. American officials still take comfort from the fact that the U. S. deficit takes a smaller share of the economy than European deficits do. And while the U. S. deficit grows out of huge tax cuts, European deficits came from massive social spending on top of already high levels of taxes.

But the prospect of a U. S. deficit of more than $150 billion by 1984—4% of the gross national product—would dramatically change that. Only Italy, whose deficit may exceed 14% of GNP this year, and West Germany, where it will hit 4.5%, would be in worse shape among the major industrial countries. That U. S. deficit would exceed the relative size of Britain's 1.9% shortfall, France's 3%, and it would be heading toward the levels of such welfare states as Sweden and Denmark.

For Europeans, the prospect of a sustained U. S. deficit is a financial nightmare. By driving up interest rates in the New York money market, U. S. borrowing has already pushed interest rates sharply higher in Europe, too. That has helped weaken their economies. But if Europe were to adopt Japan's strategy and not follow U. S. interest rate increases, its currencies would weaken drastically, leading to even more transatlantic trade friction and imported inflation for European countries.

Europeans also worry about the psychological effect of a U. S. structural deficit. "Like it or not, the U. S. is the world's economic leader as well as its political leader," says Paul Van Den Bempt, director of the National Economies Section of the European Community. "If the U. S. shows it cannot control its deficit, what kind of hope does that leave for other countries?"

Up to now, European governments have shielded their financial markets from the stress of their own deficits by financing the shortfalls through central banks and international capital markets. When France decided to boost its deficit from about 1.5% of GNP in 1980 to the current 3%, it announced that the Banque de France would buy more than 50% of the debt. Germany's federal and state governments sold an estimated $18 billion in debt to foreign buyers last year, to finance their budget and balance-of-payments deficits. Officials also note that while their shortfalls are relatively large, Europeans save much more of their income than do Americans, thus easing the strain on their financial markets.

No tax increases. Because European governments feel they can borrow as much as they need without driving up interest rates, they do not share U. S.-type concerns about big deficits crowding out private borrowers. But some European governments are worried about crowding private initiative out of the economy. Government spending among the 10 EC countries, for instance, now accounts for about 49% of GNP, up from 32% in 1960. And state and federal taxes have risen to 45% of GNP from 32% in 1960.

European economists say it would be foolish to raise taxes any more. "Heavier taxation leads to more evasion, is a disincentive to professional effort, and puts people on low incomes at a disadvantage," the EC warned in a recent report to finance ministers.

Spending limits instead. Eschewing tax increases leaves spending reductions as the only route to controlling deficits, and the British, in particular, are taking a hard line there. Prime Minister Margaret Thatcher has stopped deficits from going up by imposing cash limits, which halt inflation-indexed cost overruns. Britain is now the only European country to show a declining deficit despite the recession. In Belgium, the government used emergency powers to stop indexed social security payments.

Germany and the Netherlands are requiring consumers to pay small users' fees for socialized medical services that had been free. German hospitals now charge about $2 per day.

Still, huge government spending and deficits seem intractable. Economists at Germany's Kiel Institute say that Bonn will do well to trim government spending from nearly a 50% share of the economy today to some 44% by 1990. That reduction will take so long, they note, largely because Europe's normal unemployment rate is now closer to 8% than to the 3% level of the 1960s. With such high joblessness, governments will continue to fund generous unemployment programs in the hope of maintaining political stability.

maintain, it is unnecessary to cut any social programs or raise any new taxes. "The deficit this year is due to the recession, and those projected deficits by Stockman are just tools to get new taxes and cut programs," says Jude Wanniski, president of Polyconomics Inc. and a supply-side spokesman. This, of course, is the supply-side solution, and Wanniski admits that its theorists no longer have the President's ear. "Reagan is now acting like Nixon, Ford, and Carter," he says. The most prominent politician among the supply siders, Representative Jack F. Kemp (R-N. Y.), is attempting to kill the Dole tax bill in the House.

- The modified-growth option. Most supporters of this idea are in the Administration. They want to leave all of last year's tax cuts in place to stimulate growth, but they also believe that the budget cannot be balanced unless entitlements are cut sharply. The only areas that are untouchable are defense and the third year of Reagan's personal tax cut.
- The orthodox conservative option. Proponents of this course believe that the supply-side experiment has failed and that budget-balancing will have to come from both the expenditure and revenue sides of the ledger. They are resigned to keep the third year of the tax cut but want to eliminate the income-tax indexing scheduled for 1985 and, most important, raise revenues by broadening the tax base, primarily by doing away with loopholes. They would also scale back entitlements, especially Social Security, and cut defense spending somewhat.
- The liberal option. Most liberals believe that major cuts should be made in defense spending. They want to close tax loopholes, from a budget-balancing perspective as well as an equity standpoint, and they advocate eliminating indexation and the third year of the tax cut. They also concede that changes must be made in Social Security.
- The conservation option. The budget could be balanced, advocates argue, if the U. S. taxed energy use much as the Europeans do. In particular, they want a massive tax on gasoline.

Clearly, these various proposals cannot be fully reconciled. But what is also clear is that there is broad-based agreement on a number of key areas that hold some real promise for finally coming to grips with the built-in deficit:

PRUNE SOCIAL SECURITY AND MEDICARE. Social Security, which has almost doubled in cost over the past six years, faces very serious long-term funding problems as the nation's population ages and the number of workers supporting each retiree continues to decline. As a consequence, the government must act now to scale back the benefits that are currently locked in for future retirees. At the same time, Washington should avoid any permanent reduction in benefits for those already in retirement or about to retire. Because people plan for retirement years in advance, such a move would be a serious breach of faith. However, since indexation of Social Security in recent years has provided beneficiaries with protection against inflation unavailable to the workers whose taxes pay for the program, a one-year suspension of the cost-of-living increase or a cap at several percentage points below the consumer price index for a few years should be considered.

Medicare faces different problems. Medical care inflation is running at 15% and will bankrupt the program in three years or less. The government must also consider whether the share of expenses borne by the beneficiary should be increased. Medicare was never intended to absorb the full cost of medical treatment, and the country probably cannot afford even the existing share.

Dennis Brack/Black Star

Domenici: Reagan rejected his plan to trim Social Security cost-of-living increases.

ELIMINATE TAX INDEXATION. The government got into its current fiscal straitjacket largely because Congress indexed spending programs. The idea behind indexing tax brackets was to deprive Congress of the money generated by inflation to fund its spending spree. But clearly, not having the revenues in hand has not stopped Congress from spending. All indexing will do is add $23 billion to the deficit in 1986.

IMPOSE AN ENERGY TAX. Putting a tax on imported oil or taxing gasoline at the pump will have a double-barreled effect. It will raise considerable revenue; a 10¢ gasoline levy brings in $8 billion. It also puts pressure on OPEC and thus in the long run brings down the rate of inflation. That, in turn, allows policy to be more stimulative, thus raising GNP and indirectly generating more tax dollars.

SLOW DEFENSE SPENDING. Congressional Republicans and Democrats, as well as some Administration officials, want to slow the rate of growth of Reagan's defense spending program. Few dispute the President's goal of boosting outlays, but lawmakers on both sides of the aisle believe that such programs as the B-1 bomber, the MX missile, and the Navy's 600-ship fleet should be carefully examined to see if costs can be cut or even some aspects eliminated.

Unfortunately, Washington is very far from seriously addressing the built-in deficit. Although a working consensus is clearly needed, the differences between Republicans and Democrats and between Congress and the White House over who is responsible and what changes are necessary are so great that the political process is paralyzed. Reagan, who still defends his economic program, says the recession that has caused this year's deficit is the fault of Congress, which forced him to scale back and postpone his original three-year tax cut. He also holds that the massive out-year deficits are the responsibility of a Congress that caved in to lobbyist pressures by loading up the tax cut with extra goodies and, most important, refused to attack spending seriously.

Power struggle

Most congressional Republicans and Democrats do not accept final responsibility for the built-in deficit, although they concede that they bear some of the blame for past and present programs that have caused the red ink to become unmanageable. A number of Democrats and most Republicans initially supported Reagan's program, yet many now argue that the tax cut was too big and compressed into too short a time, given the simultaneous rapid increase in defense spending. That is why Senator Dole pushed his tax bill through the Senate and why many Democrats and Republicans, especially the Senate leadership, are furious that Reagan has waffled on what seemed to be a commitment to defense cuts in fiscal 1984 and 1985.

In fact, deep down, Congress—especially its Republican members—is inclined to blame much of the problem with the structural deficit on the President's refusal to capitalize on his political popularity to launch an attack on entitlement programs. They believe that Reagan could have done it last October, when Senator Domenici put together his plan to set a cap on cost-of-living increases for Social Security. Now, says Domenici: "I'm not sure you can solve

the deficit problem all at once. We may have to sit down and look at what spending cuts are realistically achievable and then look at defense spending from the view of how big the deficits will be if we have achieved all we can in other areas with a tax base that has been cut back."

It is widely accepted that for more than a decade, congressional control over spending has increased at the expense of the executive. The Reagan Administration had hoped to wrest control back. Its strategy was to use multiyear tax cuts and indexation of the tax code to starve the legislative branch of the revenue needed to finance expenditures. But the tactic is obviously not working.

Political gutlessness

The bottom line is whether or not politicians have the will to make political decisions that could prove costly. The failure of the Congressional Budget Act to enforce fiscal discipline on Capitol Hill shows clearly that no amount of procedural reform can ever substitute for sheer political willpower. But political guts are a scarce commodity, as demonstrated by House Speaker Thomas P. O'Neill Jr.'s abdication of his responsibility even to draft tax legislation to try to cope with the mounting deficits.

That is a major reason interest is rapidly growing in amending the Constitution to force Congress to adopt a balanced budget and to increase the powers of the President to veto expenditures program by program or to impound spending allocations. In fact, the Senate on Aug. 4 approved a bill that would generally require Congress to produce a balanced budget. But many observers worry that the lawmakers would find a way around any constitutional amendment. And Administration officials admit that the legislators are unlikely to approve a big increase in the President's authority to control the budget directly. "It is not just the Democrats," says a top Reagan aide. "The Senate Republican subcommittee chairmen are as jealous of their prerogatives as the College of Cardinals is of its."

History does not give much hope that Congress will do what is necessary to deal with the built-in deficit. But never in history has it been more imperative that Congress not pursue business as usual. Failing to deal with the deficit will preordain that the U.S. will never get back on the road to prosperity. ■

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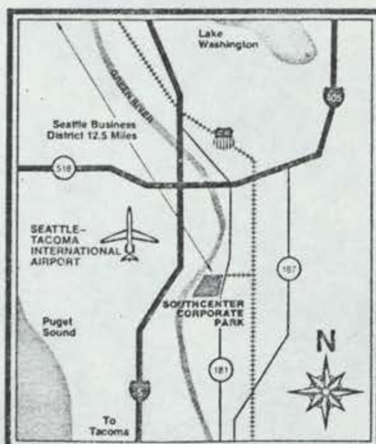

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