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INFO SAVING: PARIS, BONN, UKREP BRUSSELS, UKDEL NATO, TOKYO.

MYTELNO 243 OF 31 JANUARY: INITIAL REACTIONS TO PRESIDENT
REAGAN'S FY84 BUDGET PROPOSALS

SUMMARY

1. INITIAL REACTIONS TO PRESIDENT REAGAN'S FY84 BUDGET PROPOSALS IN CONGRESS, THE PRESS AND AMONGST ECONOMIC COMMENTATORS HAVE BEEN MIXED. THE MORE REALISTIC FORECASTS FOR ECONOMIC GROWTH WERE WELCOMED. THERE IS ALSO AGREEMENT ON ALL SIDES THAT THE BUDGET DEFICIT NEEDS TO BE REDUCED. BUT THERE ARE DOUBTS ABOUT WHETHER THE PROPOSALS FOR REDUCING THE DEFICIT REFLECT ANY MAJOR CHANGE IN THE ADMINISTRATION'S PRIORITIES. THE CONGRESSIONAL BUDGET PROCESS WILL IN ANY CASE TAKE 9 MONTHS AND NO CLEAR BATTLE LINES HAVE YET BEEN DEFINED. BUT SUCCESSFUL PASSAGE OF MEASURES FOR REDUCING THE DEFICIT WILL PROBABLY DEPEND ON HOW MUCH GROUND THE ADMINISTRATION IS PREPARED TO GIVE IN STRIKING A BALANCE BETWEEN REDUCING EXPENDITURE AND RAISING TAXATION AND BETWEEN REDUCING CIVIL AND CURBING THE GROWTH OF MILITARY EXPENDITURE.

DETAIL

2. IT IS TOO EARLY TO PREDICT HOW CONGRESS WILL DIVIDE ON THE MAIN ISSUES DURING THE PROCESS OF TRYING TO GET THE BUDGET THROUGH CONGRESS, WHICH WILL TAKE AT LEAST 9 MONTHS (FY84 STARTS ON 1 OCTOBER 1983). WITH THE INCREASED DEMOCRATIC MAJORITY IN THE HOUSE FOLLOWING THE CONGRESSIONAL ELECTIONS IN NOVEMBER 1982, THE BUDGET PROPOSALS WILL NOT PASS AS THEY STAND, AND NO DOUBT THERE IS MUCH WHEELING AND DEALING TO COME. THE FIRST FORMAL CONGRESSIONAL PROCEDURES RELEVANT TO THE FY84 BUDGET ARE TAKING PLACE IN THE BUDGET COMMITTEES OF EACH HOUSE, WHO ARE UNDER A STATUTORY OBLIGATION TO REPORT BUDGET PROPOSALS BY 15 MARCH, WITH A VIEW TO A FIRST BUDGET RESOLUTION TO ESTABLISH A COMMON TARGET FOR TOTAL RECEIPTS AND EXPENDITURE BEING AGREED BY 15 MAY. THEREAFTER THE PROPOSALS HAVE TO GO THROUGH THE MILLS OF AUTHORISATIONS AND APPROPRIATIONS COMMITTEES BEFORE THE WHOLE PROCESS CAN BE COMPLETED, THEORETICALLY IN SEPTEMBER.

3. CONGRESS IS LIKELY TO ACCEPT THE NEED FOR ACTION TO REDUCE THE SIZE OF BUDGET DEFICITS OVER THE BUDGET PERIOD. BUT THE DEMOCRATS ARE UNLIKELY TO AGREE WITH THE PRESIDENT'S ASSERTION THAT THE DEFICITS OWE NOTHING TO HIGHER PLANNED DEFENCE SPENDING OR TO THE PROGRAMME OF PHASED CUTS IN INCOME TAX, BUT RATHER THE RAPID GROWTH OF ENTITLEMENT EXPENDITURE ON INCOME SUPPORT, HEALTH CARE AND WELFARE PAYMENTS. THEY POINT TO THE DISPARATE COMPONENTS OF THE PROPOSED 'EXPENDITURE FREEZE' FOR FY84, WHICH CONSISTS OF A GROWTH IN DEFENCE SPENDING OF OVER 10 PERCENT IN REAL TERMS AND A DECLINE IN

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OTHER SPENDING (EXCLUDING INTEREST PAYMENTS) OF OVER 5 PERCENT IN REAL TERMS. THEY ARE LIKELY TO OPPOSE THE PRESIDENT'S PROPOSALS TO RESTRAIN THE GROWTH OF MEDICARE BENEFITS, ENTITLEMENT PROGRAMMES SUCH AS FOOD STAMPS AND FARM PRICE SUPPORTS, SINCE THEY REGARD IT AS INAPPROPRIATE TO CONCENTRATE SPENDING CUTS IN SECTORS AFFECTING THOSE WHO ARE BEARING THE WORST EFFECTS OF THE RECESSION.

4. THE ADMINISTRATION'S PROPOSALS TO FREEZE FEDERAL CIVILIAN AND MILITARY PAY AND PENSIONS WILL BE RESISTED BY STRONG PRESSURE GROUPS AND THERE WILL BE INSISTANCE THAT ANY SAVINGS ON MILITARY EXPENDITURE MUST BE FOUND ELSEWHERE (E.G. SENATOR WARNER'S PROPOSAL FOR A 5 PERCENT REDUCTION IN MILITARY MANPOWER LEVELS.) BUT THE GREENSPAN COMMISSION PROPOSALS FOR SOCIAL SECURITY REFORM MAY RECEIVE MORE SUPPORT IN VIEW OF THE URGENT NEED TO TACKLE THE FINANCIAL PROBLEMS OF THE TRUST FUNDS.

5. THE DEMOCRATIC ALTERNATIVE APPROACH HAS BEEN DESCRIBED BY TIP O'NEILL (D.-HOUSE SPEAKER) AS SUPPORT FOR 'A BUDGET THAT WILL INCLUDE A MAJOR COMMITMENT TO CREATING JOBS AND STIMULATING THE ECONOMY'. THE DEMOCRATS HAVE CRITICISED THE BUDGET FOR ITS LACK OF NEW JOBS PROGRAMMES AND ARE LIKELY TO PROPOSE NEW PROGRAMMES TO EXPAND EMPLOYMENT IN THE PUBLIC SECTOR. BUT THE PRESIDENT HAS STATED THAT IN PRINCIPLE HE REMAINS OPPOSED TO TEMPORARY MAKE-WORK JOBS PROGRAMMES.

6. THE PRESIDENT'S PROPOSALS FOR A CONTINGENCY TAX INCREASE TO TAKE EFFECT IN OCTOBER 1985 HAVE COME IN FOR HEAVY CRITICISM. THERE IS LITTLE SUPPORT IN CONGRESS FOR THE PRINCIPLE OF A STANDLY TAX IF THIS IS INTENDED TO LIMIT ITS FUTURE DISCRETIONARY POWER OVER TAXATION. INSTEAD, THE DEMOCRATS HAVE SUGGESTED ELIMINATING OR REDUCING THE AMOUNT OF THE CUT IN INCOME TAX SCHEDULED TO TAKE EFFECT THIS JULY, AND/OR AMENDING THE LEGISLATION PROVIDING FOR INDEXATION OF INCOME TAX THRESHHOLDS IN JANUARY 1985. THE PRESIDENT OPPOSES THESE COUNTER-PROPOSALS. IF BOTH THE CONTINGENCY TAX PLAN AND REDUCING THE SCHEDULED INCOME TAX CHANGES ARE DOUBTFUL STARTERS, THEN IT IS UNCERTAIN WHERE ADDITIONAL REVENUES WILL COME FROM.

7. THE MAJORITY OF ECONOMIC COMMENTATORS REMAIN CAUTIONS ABOUT THE ADMINISTRATION FORECAST OF 4 PERCENT ECONOMIC GROWTH BEGINNING IN 1984. ALTHOUGH SUCH A GROWTH RATE IS BY PAST STANDARDS NOT IMPLAUSIBLE, IT IS THOUGHT THAT MUCH DEPENDS ON WHETHER FINANCIAL MARKETS WILL BE CONVINCED THAT FUTURE BUDGET DEFICITS WILL BE REDUCED. THE PRINCIPAL CONCERN IN THE MARKETS IS THAT LARGE DEFICITS WILL CROWD OUT THE PRIVATE DEMAND FOR CREDIT AS THE RECOVERY PROCEEDS, OR WILL BE INFLATIONARY IF THE FED ACCOMMODATES THEM. SOME COMMENTATORS, E.G. RUDOLPH PENNER OF THE AMERICAN ENTERPRISE INSTITUTE, ARGUE THAT THE ADMINISTRATION'S FORECASTS ARE UNDULY PESSIMISTIC AND THAT THE RECOVERY WILL BE MORE BUOYANT, LEADNING TO LOWER DEFICITS. BUT

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EVEN PENNER ACCEPTS THAT THE DEFICIT WILL NOT FALL SIGNIFICANTLY UNLESS SOME ACTION IS TAKEN. FINANCIAL MARKETS WILL BE INFLUENCED HEAVILY BY ANY INDICATION OF WHETHER OR NOT THE CONGRESS IS WILLING TO TAKE THE NECESSARY ACTION. SO FAR THEY APPEAR NOT TO HAVE BEEN CONVINCED, SINCE INTEREST RATES HAVE BEEN EDGING UPWARDS IN THE PAST WEEK OR SO.

8. FCO PLEASE PASS TO PS/CHANCELLOR OF THE EXCHEQUER, PS/LITTLER AND BOTTRILL (TREASURY) AND WATSON (BANK OF ENGLAND)

FCO PASS SAVING PARIS, BONN, UKREP BRUSSELS, UKDEL NATO AND TOKYO.

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