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THE BATTLE OF THE BUDGET: WHERE TO CUT?

by David Brauer

Most economists and politicians agree that the federal deficit must be substantially reduced from its current level of around $200 billion. Such a deficit is unprecedented in American history, and is already being blamed for causing high real interest rates, which in turn keep the dollar strong by attracting capital from abroad. We have recently been hearing about the plight of the farmers, which is at least partly caused by high interest rates and the strong dollar, but other producers of internationally traded goods are also being hurt. Some economists fear that the continuation of high deficits will lead to renewed inflation, while others worry that the Federal Reserve will impose tight monetary policies in order to prevent this from occuring, resulting in even higher interest rates and a new recession.

In any case, it is clear that the deficit cannot be sustained at current levels. In the past, deficits were seen as resulting from what economists call automatic stabilizers. This means that when the economy falls into a recession, tax revenues automatically decline, while certain expenditures (such as unemployment insurance payments) rise. The resulting deficit helps to stimulate renewed growth, thereby correcting itself. The present deficit is different; it is so large that even if the economy were operating at full employment it would not disappear. Therefore it is clear that some combination of tax increases and spending reductions will be needed.

It is highly unlikely that tax increases will play a major role in deficit reduction, given President Reagan's promise to veto any increase. One major cause of the current deficit has been the massive tax cuts enacted in 1981, but the Administration claims an electoral mandate for preserving these cuts. Shortly after last November's election there was some discussion of passing disguised tax increases as part of a tax simplification plan (see LCR 146, accompanying this article). It now appears, however, that no such plan will pass unless it maintains strict revenue neutrality. Furthermore, according to a recent *New York Times*/CBS News poll, 81% of the public agrees that the deficit should be reduced through spending cuts, not tax increases. Given that tax increases are unlikely, the crucial question becomes where to cut spending. Certain areas of the budget are untouchable; nearly 15% goes simply to pay interest on debt incurred as a result of previous deficits, with another 30% going for Social Security, Medicare, and other forms of social insurance. This essentially leaves domestic programs, including means-tested benefits, and the military as possible areas out of which cuts can be made.

The Reagan Administration's position on this question is perfectly clear. When first elected the President claimed a mandate to escalate military spending while slashing domestic programs. In 1981 (the last budget prepared by the Carter Administration), the military received about 24% of the budget; in the current fiscal year its share is about 30%. Many domestic programs have already been reduced or eliminated, especially those (such as Food Stamps and AFDC) which mostly benefit the poor. In its first term the Administration received about 60% of the domestic spending cuts that it asked for, and according to one study cuts in welfare would have been twice as large, and in Food Stamps four times as large as they actually were, had Congress passed everything the Administration proposed.

Current Administration Proposals—Now a new assault on domestic spending is underway. The Administration proposes the complete elimination of federal funding for 26 programs, including the Job Corps, Amtrak, and the Legal Services Corporation. Urban-related programs, such as general revenue sharing and subsidies for urban mass transit, would be especially hard-hit, with cities forced to absorb these cuts through either (ironically) higher local taxes or reductions in the level of basic services provided. Other programs, such as Medicare, Medicaid, child nutrition, and housing assistance, are to be frozen at current levels, meaning that the quantity or quality of services provided will decline. If all of the Administration's proposals are accepted—many undoubtedly will not be—an estimated $51 billion would be saved.

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President Reagan will likely try to draw attention to such "obvious" examples of waste as paying corporate farmers not to produce or making loans available, at interest rates well below the market, to students from high income families, but this should not obscure the overall thrust of the Administation's policies. In his veto of emergency farm credit legislation, Reagan made explicit his determination to hold down domestic spending, saying:

> *The bottom line is that someone in Washington must be responsible. Someone must be willing to stand up for those who pay America's bills, and someone must stand up to those who say here's the key, there's the Treasury, just take as many of your hard-earned tax dollars as you want. . . I will veto again and again until spending is brought under control.*

This last statement is belied not only by the fact that Reagan himself has presided over the largest deficits in history, but also by the fact that no such standard is being applied to the Pentagon. Defense spending has already increased from $157.5 billion in 1981 to $283.1 billion in the current fiscal year (an approximate 40% increase after accouting for inflation), but this is not enough for the Administration. The current proposed budget would increase the military budget a further 8% after inflation, and by 1988 the defense budget would be an estimated $385.2 billion (or 35% of the overall Federal budget) if all White House proposals are adopted. For example, the Pentagon has requested 48 new MX missiles (which, judging from recent statements, are to be used merely as bargaining chips in upcoming negotiations with the Soviets) at a cost of $4 billion. Alternatively, this money could provide funding for general revenue sharing and Amtrak at existing levels. Merely freezing the already large military budget at its current level in real terms would save $20 billion this year, with further savings in the next several years.

Prospects for Deficit Reduction—The chance of achieving actual spending cuts is uncertain. Congress will likely approve some, but not all, of the Administration's requests for domestic savings. As noted above, however, the President threatens to veto any budget which provides for "too much" domestic spending; if he does so Congress almost certainly will not vote to override it. With respect to defense spending, even many Republicans in Congress oppose appropriating more than a 3% real increase above current levels, and Reagan is powerless to spend more than what's been approved. At this writing the Senate Budget Committee has approved a compromise plan limiting defense increases to the rate of inflation and freezing most other spending at current levels; it remains to be seen how far this will go or what the White House reaction will be. While this is not an ideal plan, since it freezes in place priorities already established through previous Reagan budgets, it may be the best that can be hoped for, with the effect of at least slowing down the Reagan Revolution calling for slashing social programs in order to spend billions more on the military. But it should be remembered that even a complete, three year budget freeze would, in the absence of tax increases, still leave a deficit of around $100 billion. This would be an ironic legacy for a president who proposes a constitutional amendment mandating balanced budgets.

-- David Brauer