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FM WASHINGTON 141840Z

TO PRIORITY F C O

TELNO 1345 OF 14 MAY 1983,

INFO SAVING PARIS, ROME, BONN, TOKYO, UKREP BRUSSELS, UKDEL OECD.

PROSPECTS FOR REDUCING THE US BUDGET DEFICIT:

LATEST DEVELOPMENTS IN CONGRESS.

SUMMARY.

THE ANNUAL US BUDGET BATTLE IS PROVING IF ANYTHING MORE THAN USUALLY DIS-ORDERLY. THE CONGRESSIONAL CALENDAR REQUIRES THE PASSAGE OF AN AGREED FIRST BUDGET RESOLUTION BY 15 MAY. AS OF THE END OF LAST WEEK, SUCH A RESOLUTION WAS NOWHERE IN SIGHT. THE SENATE HAD HAD TO ADMIT FAILURE TO REACH A COMPROMISE. WITH THE PRESIDENT DUG IN AGAINST EFFECTIVE TAX INCREASES AND IN FAVOUR OF A SUBSTANTIAL INCREASE IN DEFENCE SPENDING, THE PESSIMISTS WERE BEGINNING TO TALK OF THE POSSIBILITY OF FAILURE TO GET A 1984 BUDGET AT ALL AND OF HAVING TO OPERATE ON THE BASIS OF CONTINUING RESOLUTIONS. IT IS TOO EARLY TO REACH THAT CONCLUSION YET, OR ANYTHING LIKE IT. BUT THE PRESENT POSITION IS CERTAINLY A MESS.

2. FOR THOSE WHO NEED IT, A FULLER PICTURE OF WHERE THE PROCESS HAS GOT TO AND WHAT THE PROSPECTS ARE IS SET OUT BELOW.

DETAIL.

1. THE SENATE, ON 12 MAY REJECTED BY A VOTE OF 52-48 A COMPROMISE FIRST BUDGET RESOLUTION BACKED BY THE ADMINISTRATION. PRESIDENT REAGAN'S INSISTENCE THAT PROVISION SHOULD BE MADE FOR FY84 MILITARY EXPENDITURE TO RISE AT LEAST 7.5% IN REAL TERMS AND THAT TAX INCREASES IN THAT YEAR SHOULD BE LIMITED TO DOLLARS 2.6 BILLION WERE KEY FACTORS IN THE DEFEAT OF THE ADMINISTRATION COMPROMISE. AN ALTERNATIVE COMPROMISE PROPOSED BY MODERATE REPUBLICAN SENATORS, PROVIDING FOR GROWTH IN DEFENCE SPENDING OF 6% AND REVENUE INCREASES OF DOLLARS 9 BILLION WAS ALSO DEFEATED. AS A RESULT OF THIS IMPASSE THE RESOLUTION HAS BEEN REFERRED BACK TO THE SENATE BUDGET COMMITTEE WITH INSTRUCTIONS THAT THE COMMITTEE SHOULD REPORT A FRESH RESOLUTION BY 17 MAY.

2. PRESIDENT REAGAN ALLOWED HIS CHIEF BUDGET LIEUTENANTS IN THE SENATE (MAJORITY LEADER BAKER AND CHAIRMAN OF THE BUDGET COMMITTEE DOMENICI) TO INCORPORATE DOLLARS 11 BILLION MORE IN DOMESTIC FY 84 SPENDING IN THE ADMINISTRATION COMPROMISE THAN HAD BEEN PROVIDED FOR IN HIS ORIGINAL BUDGET. THIS WAS HOWEVER INSUFFICIENT TO BREAK DEMOCRATIC SOLIDARITY WHICH, SUPPLEMENTED BY THE VOTES OF THE REBEL REPUBLICANS, CAUSED THIS COMPROMISE TO BE DEFEATED.

3. DOMENICI AND BAKER LOBBIED ON BEHALF OF THE PRESIDENT AGAINST THE REPUBLICAN MODERATES' ALTERNATIVE DRAFT RESOLUTION. THE DOLLARS 9 BILLION OF REVENUE INCREASES INCLUDED IN THAT RESOLUTION MIGHT HAVE MEANT A LIMIT ON THE AMOUNT EACH INDIVIDUAL COULD SAVE FROM THE 10% CUT IN INCOME TAX RATES SCHEDULED FOR JULY, AND ALSO CONTAINED PROVISIONS FOR FY 85 AND BEYOND THAT COULD HAVE IMPLIED THE REPEAL OF LEGISLATION INDEXING TAX RATES TO INFLATION. THUS THE MODERATES PLAN WAS AN ATTACK ON THE TAX REDUCTIONS WHICH PRESIDENT REAGAN BELIEVES ARE AN ESSENTIAL PART OF HIS ECONOMIC PROGRAMME.

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4. WHETHER OR NOT THE SENATE PASSES THE FIRST BUDGET RESOLUTION NEXT WEEK, THE PROSPECTS FOR A US BUDGET COMPROMISE LOOK CLOUDED. THE BUDGET RESOLUTION PASSED BY THE HOUSE OF REPRESENTATIVES ON 23 MARCH, PROVIDING FOR FY 84 REVENUE INCREASES OF DOLLARS 30 BILLION AND A REAL INCREASE IN DEFENCE SPENDING OF 5% (COMPARED WITH 10% REQUESTED BY THE PRESIDENT AND THE 7.5% FOR WHICH HE WAS PREPARED TO SETTLE), APPEARS TO BE A NON-RUNNER IN THE SENATE AND WOULD BE UNACCEPTABLE TO THE ADMINISTRATION.

5. THE PRESENT POSITION THEREFORE IS THAT THE PRESIDENT IS INSISTING (A) ON THE IMPLEMENTATION OF HIS TAX REDUCTIONS; (B) ON A REAL INCREASE IN DEFENCE SPENDING OF AROUND 7% AND (C) THAT THERE CAN BE NO SIGNIFICANT INCREASE IN TAXATION TO ALLOW FOR MORE CIVIL SPENDING AND SOME REDUCTION IN THE BUDGET DEFICIT, PROJECTED AT DOLLARS 190 BILLION FOR FY84.

6. THE WHITE HOUSE SPOKESMAN SAID THIS WEEK THAT THE PRESIDENT WOULD RATHER SEE CONGRESS PASS NO BUDGET AT ALL THAN ONE THAT SIGNIFICANTLY INCREASED TAXES IN FY84. IN THOSE CIRCUMSTANCES, THE ADMINISTRATION WOULD HOPE, BY A COMBINATION OF CONTINUING RESOLUTIONS AND SPECIAL APPROPRIATIONS BILLS, TO SECURE MAJOR ITEMS WHICH THEY WANT (PARTICULARLY DEFENCE SPENDING) WHILE PREVENTING THE DEMOCRATS FROM IMPLEMENTING THEIR OWN PET MEASURES. THERE IS A LARGE TACTICAL ELEMENT IN APPROACH, WITH THE ADMINISTRATION AFFECTING TO IGNORE THE CONSEQUENCES OF FAILURE TO AGREE A BUDGET, IN TERMS OF GROWTH OF THE BUDGET DEFICIT AND THE IMPACT THAT COULD HAVE ON US ECONOMIC RECOVERY. IN PRACTICE, IT CANNOT IGNORE THE GROWING DEFICIT, NOT LEAST BECAUSE REPUBLICANS IN THE SENATE, (GLANCING NERVOUSLY OVER THEIR SHOULDERS AT LAST NOVEMBER'S ELECTION RESULTS AND LOOKING FORWARD WITH SOME APPREHENSION TO 1984), ARE CONCERNED ABOUT THE IMPLICATIONS. THE PRESIDENT CAN AFFORD TO PLAY HAND BALL WITH THE DEMOCRATS BUT CANNOT THUMB HIS NOSE AT THE LEADERS OF HIS OWN PARTY IN THE SENATE, ALL OF WHOM WANT TO REACH A COMPROMISE. THE ODDS ARE THEREFORE STILL IN FAVOUR OF SOME DEAL AT THE LAST MINUTE. WHAT IS CERTAIN IS THAT THE 'REFORMED' BUDGET PROCEDURE, WHICH WAS DESIGNED TO ENABLE CONGRESS AND THE ADMINISTRATION TO SET OVERALL SPENDING TARGETS BEFORE GETTING DOWN TO THE BUSINESS OF APPROPRIATIONS, IS PROVING WELL NIGH IMPOSSIBLE TO OPERATE. COMPREHENSIVE BUDGETS HAVE HARDLY EVER BEEN ADOPTED SINCE THE NEW PROCEDURE WAS INTRODUCED IN 1974.

7. FCO PLEASE PASS TO BROADBENT (ESID), BOTTRILL (TREASURY) AND WATSON (BANK).

FCO PASS SAVING: PARIS, ROME, BONN, TOKYO, UKREP BRUSSELS AND UKDEL
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