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Mr Turnbull

US BUDGET DEFICIT: PRESIDENTS PROPOSALS

1. SUMMARY

THE PRESIDENT, WITH THE SUPPORT OF REPUBLICAN LEADERS IN THE SENATE, HAS ANNOUNCED REVISED BUDGET PROPOSALS, INCLUDING SIGNIFICANT CUTS IN THE PROPOSED DEFENCE BUDGET, TO REDUCE THE FEDERAL DEFICIT. THE PACKAGE HAS STILL TO OBTAIN THE AGREEMENT OF THE DEMOCRATIC HOUSE.

2. THE PRESIDENT ANNOUNCED YESTERDAY A PACKAGE TO LOWER THE BUDGET DEFICIT BY DOLLARS 150 BN BETWEEN FY85-87, FOLLOWING AGREEMENT BETWEEN THE ADMINISTRATION AND SENIOR REPUBLICANS IN CONGRESS. IT PROVIDES FOR SOME ADDITIONAL CUTS OVER AND ABOVE THOSE PROPOSED IN THE PRESIDENT'S FY85 BUDGET. THE BUDGET PROVIDED FOR CUTS OF DOLLARS 72 BN IN SPENDING AND INCREASES IN REVENUE OF DOLLARS 34 BN BETWEEN FY85-87, YIELDING DEFICITS IN THE REGION OF DOLLARS 180 BN IN EACH OF THOSE YEARS. THE LATEST PROPOSALS WOULD CUT THE DEFICIT TO DOLLARS 169 BN IN FY85, DOLLARS 150 BN IN FY86 AND DOLLARS 143 BN IN FY87.

3. THE PACKAGE CONSISTS OF WHAT IS TERMED QUOTE A DEFENCE COMPROMISE UNQUOTE, ALLOWING FOR SAVINGS IN THE RATE OF INCREASE OF DEFENCE OUTLAYS, AMOUNTING TO DOLLARS 40.2 BN: CUTS IN NON-DEFENCE SPENDING OF DOLLARS 43.2 BN, INCREASES IN TAX REVENUES OF DOLLARS 48 BN AND RESULTING SAVINGS THROUGH LOWER INTEREST COSTS ON THE DEBT OF A FURTHER DOLLARS 18 BN. MOST OF THE SAVINGS WOULD BE REALISED IN THE SECOND AND THIRD YEAR OF THE FY85-87 PERIOD. FURTHER DETAILS ARE BEING SENT TO LONDON BY BAG.

4. THE COMPROMISE AGREEMENT ON DEFENCE REPRESENTS AN IMPORTANT SHIFT IN THE ADMINISTRATION'S VIEW OF THE APPROPRIATE RATE OF INCREASE IN DEFENCE SPENDING. FOR FY85 DEFENCE SPENDING IN REAL TERMS IS PLANNED TO RISE BY 5.1 PER CENT, CLOSE TO THE TARGET FIGURES ADOPTED LAST YEAR BY CONGRESS IN ITS BUDGET RESOLUTION FOR 1984, WHICH PROVIDED FOR REAL INCREASES OF 5 PER CENT IN DEFENCE BUDGET AUTHORITY FOR FY84 AND 85. COMPARED TO THE AMOUNT ACTUALLY APPROPRIATED IN 1984, THE REAL INCREASE IN DEFENCE SPENDING IS OVER 7 PER CENT. BUT IT REMAINS SUBSTANTIALLY BELOW THE 13 PER CENT REAL INCREASE ORIGINALLY SOUGHT BY THE ADMINISTRATION. IN ADDITION THE ADMINISTRATION HAS MADE NO SPECIFIC PROPOSALS FOR CUTS IN ANY PARTICULAR PROGRAMME, WHICH IT HAD EARLIER ARGUED WAS NECESSARY BEFORE IT COULD AGREE TO LOWERING THE INCREASE IN DEFENCE SPENDING. THE MAIN PROPOSALS OF THE THREE YEAR AGREEMENT ON DEFENCE SPENDING ARE:-

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	1985	1986	1987
BUDGET AUTHORITY (DLS BN)	299.0	333.7	372.0
BUDGET OUTLAY (DLS BN)	266.0	294.6	330.4
REAL GROWTH RATE (PER CENT)	5.1	5.0	4.9

5. THE TAX MEASURES COVER A LARGE NUMBER OF SMALL REVENUE-RAISING PROPOSALS, MANY OF WHICH AIM TO CLOSE TAX-LOOPHOLES, AND ARE REPORTED TO HAVE THE SUPPORT OF TREASURY SECRETARY REGAN. OF THE DOLLARS 48 BN OF TAX REVENUES, THE ADMINISTRATION HOPE THAT OVER DOLLARS 38 BN WILL BE DERIVED FROM MEASURES INCLUDED IN THE SIMILAR BILLS CURRENTLY UNDER CONSIDERATION BY THE HOUSE WAYS AND MEANS COMMITTEE AND APPROVED YESTERDAY BY THE SENATE FINANCE COMMITTEE. THE DOMESTIC SPENDING CUTS AFFECT A NUMBER OF ENTITLEMENT PROGRAMMES, OTHER DISCRETIONARY PROGRAMMES, AND PROVIDES FOR A FREEZE ON FARM TARGET PRICES.

6. HOUSE DEMOCRATS HAVE NOTED THE PRESIDENT'S PROPOSAL, BUT HAVE STATED THEY WILL PRESS FOR FURTHER CUTS IN DEFENCE SPENDING. CONGRESS HAS UNTIL 15 MAY TO REACH AGREEMENT ON ITS FIRST BUDGET RESOLUTION.

7. THE INITIAL MARKET REACTION TO THE NEWS WAS POSITIVE. BUT THE LONGER TERM ECONOMIC SIGNIFICANCE OF THE MEASURES DEPENDS ON THE AMOUNT OF ADDITIONAL SAVINGS THAT ARE EVENTUALLY AGREED AND THEIR PHASING OVER THE THREE YEAR PERIOD. THE CONCERN OF MANY, INCLUDING FEDERAL RESERVE CHAIRMAN VOLCKER, IS THAT ADDITIONAL CUTS OF ONLY SOME DOLLARS 10 BN IN FY85, OVER AND ABOVE THE ORIGINAL BUDGET PROPOSALS, MAY NOT BE SUFFICIENT TO OFFSET THE PRESSURE ON INTEREST RATES FROM THE SIGNS OF GROWING PRIVATE SECTOR DEMAND FOR CREDIT. INTEREST RATES HAVE RISEN IN RECENT WEEKS. HIGHER INTEREST RATES THAN ASSUMED BY THE ADMINISTRATION IN ITS BUDGET CALCULATIONS, LEADING TO HIGHER INTEREST CHARGES ON THE DEBT, WOULD OFFSET SOME OF THESE SAVINGS.

8. THE PRESIDENT'S DEFICIT REDUCING PACKAGE HAS RETURNED THE POLITICAL INITIATIVE TO THE ADMINISTRATION. IF THE DEMOCRATIC HOUSE TURNS IT DOWN, THE REPUBLICANS CAN ACCUSE THE DEMOCRATS OF FISCAL IRRESPONSIBILITY. THOUGH INITIAL MARKET REACTION HAS BEEN POSITIVE, IT IS TOO SOON TO JUDGE WHETHER THE DEFICIT REDUCTION, IF AGREED, WOULD CARRY THE ECONOMY THROUGH THE REST OF THIS YEAR WITHOUT FURTHER PERTURBATIONS IN THE EXCHANGE AND MONEY MARKETS. BUT IT DOES SHOW THAT THE ADMINISTRATION AND ITS SUPPORTERS IN THE SENATE CAN ACT QUICKLY TO PUT TOGETHER A USEFUL PACKAGE WHEN GOADED BY BAD NEWS FROM THE FINANCIAL MARKETS. IT REMAINS TO BE SEEN WHETHER THE HOUSE OF REPRESENTATIVES WILL BUY IT SO THAT THE REDUCED BUDGET CAN PASS INTO LAW.

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