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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

CONFIDENTIAL

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MEMORANDUM TO THE PRESIDENT

FROM: DAVID A. STOCKMAN *DAS*
RE: HUMAN EVENTS ARTICLE ON 1985 BUDGET

Summary of Key Points

- 1) Our budget is up \$200 billion from Carter's -- but 92% of the increase was necessary or beyond our control.
- 2) We are taking a larger share of the economy than Carter's last budget -- but not on account of domestic spending increases. Instead, the total GNP share is up because we have not been able to pull down domestic spending fast enough to off-set increases for defense, debt service and national interest programs.
- 3) The charge that our 1985 Budget savings of \$4.6 billion are "paltry" fails to recognize that due to the election our hands were tied on 65% of the domestic budget and that necessary increases for priority programs off-set some of our savings.
- 4) When you adjust for factors beyond our control -- debt service, unemployment and a two-year explosion in farm subsidies -- our spending record is better not worse than Carter's, as charged by Human Events. Omitting the above items, our first two non-defense budgets were up 9% compared to 25% under Carter's first two years.
- 5) While using accurate facts to arrive at inappropriate conclusions on the above items, the Human Events article ignores the following Reagan budget successes:
 - o \$318 billion in enacted savings over 1982-86;
 - o freeze on constant dollar domestic spending from 1981-1989 compared to 915% increase over prior 3 decades;
 - o 1954-1981 Federal welfare cost explosion totally stopped by Reagan reforms;
 - o Great Society programs already cut by 31% in constant dollars.

OVERVIEW

The Human Events article entitled "Reagan Budget: Worse than You've Heard" must be handled carefully. Unlike the usual media drumbeat against us, all of the significant facts used in this article are essentially accurate. Unfortunately, however, they have not bothered to explore all of the facts and fail to recognize many of the budget circumstances which have been beyond our control.

Thus, the implied conclusion of the article -- that we are big spenders or even worse spenders than the Carter Administration -- is totally wrong. To demonstrate this, Section I provides a proper interpretation of the accurate facts which have been misunderstood by Human Events. Section II covers the more important facts about the budget which they have completely ignored and which document our substantial progress on spending control despite all the factors we did not anticipate.

Since Human Events is highly supportive of most Administration policies, I would recommend that the points below be used for the purpose of clarification rather than argumentation. They could be phrased as follows: "We know that spending is still too high, but we have discovered certain facts that Human Events has possibly overlooked. For instance,...."

I. CORRECT FACTS USED BY HUMAN EVENTS AND THEIR PROPER INTERPRETATION

HUMAN EVENTS CHARGE #1: \$200 BILLION HIGHER SPENDING THAN CARTER

"The grim but overriding reality of Ronald Reagan's proposed budget (FY 1985) is that it is nearly \$200 billion fatter than Jimmy Carter's last budget (FY 1982) which Reagan denounced for its waste and extravagance."

- o The actual 1982 budget was \$728 billion -- slightly less than the proposed FY 1982 budget Carter left on the table. Since our budget for 1985 is \$925 billion, it is factually accurate to say that the budget has increased about \$200 billion or 27% in three years compared to where Carter left off.
- o However, as shown below, Human Events has totally ignored the reasons why the budget is up by \$200 billion:
 - o Nearly two-thirds of the increase (\$127 billion) is due to defense, national interest programs* and debt service. Human Events supports the first two and nothing can be done about the latter in the short-run.

- o Another 28% of the increase (\$55 billion) is due to automatic spending for social security, federal pensions, unemployment and medicare. These were put in place before we got here and Congress has rejected, or we have withdrawn under political pressure, many of our reform proposals to reduce the cost of these laws.
- o Only \$15 billion or 8% of the increase is attributable to domestic discretionary and means-tested welfare programs -- the area where most of our cuts have been focused. Thus, while the total three-year increase is \$200 billion, less than one-tenth is for things not needed or which could have possibly been avoided single-handedly by the Reagan Administration.

COMPOSITION OF \$200 BILLION SPENDING
INCREASE SINCE 1982

<u>Budget Component</u>	<u>1982 Actual</u>	<u>1985 Budget</u>	<u>Increase Amount</u>	<u>% of Total Increase</u>
o Department of Defense	\$181	\$264	+\$84	42%
o National Interest Programs*	21	33	+12	6%
o Debt Service	85	116	+31	16%
Subtotal	287	414	+127	64%
o Social Security, Pensions Medicare/UI	249	304	+55	28%
o Other Domestic Spending ..	193	208	+15	8%
Total Spending	\$728	\$925	+\$197	100%

* "National Interest Programs" include: Atomic weapons program (DOE), Security Assistance, foreign aid, space, international broadcasting, defense preparedness and stockpile and Coast Guard

HUMAN EVENTS CHARGE #2: SPENDING SHARE OF GNP HIGHER THAN CARTER

"Federal spending stood at 22.8% of GNP when Reagan took office; it now stands at 24% and even the projected Stockman savings would bring spending down to a heavy 23.8% of GNP by the end of fiscal 1985 -- higher than when President Carter was in power."

- o It is a fact that during our first four years federal spending will take a larger share of the economy than any previous time in peacetime history:

<u>Average for Period:</u>	<u>Federal Spending Share of GNP</u>
Eisenhower (1954-61)	18.5%
Kennedy-Johnson (1962-69)	19.5%
Nixon-Ford (1970-1977)	20.7%
Carter (1978-81)	21.8%
Reagan (1982-85)	24.1%

Recent Years

<u>Carter:</u>		<u>Reagan:</u>	
1978	21.4%	1982	23.8%
1979	20.8%	1983	24.7%
1980	22.4%	1984	24.0%
1981	22.7%	1985	23.8%

- o Again, however, these single figures for the total federal spending share of the economy fail to point out the reasons why spending has gone up. One important reason is that while we have cut the average annual growth rate of federal spending by 30% compared to the Carter period, the annual growth rate of the economic base (GNP) during our period has fallen by slightly more -- 32%. The latter is due to the fact that we have had a prolonged, deep recession and Carter didn't; and that inflation was rapidly rising during the Carter period while it has fallen rapidly during our period. In short, the consequence of turning around the economy and eliminating double-digit inflation was a slower, but more healthy and sustainable growth of the economic base. For our first four years this basic economic adjustment has helped to keep the federal spending share of GNP high.

	<u>Average growth rate of Federal Spending</u>	<u>Average growth rate of Economic Base (Nominal GNP)</u>	<u>Ratio</u>
Carter period (1978-81) ..	13.1%	11.5%	1.14
Reagan Period (1982-85) ..	9.1%	7.8%	1.17
Change in Growth Rate	-30%	-32%	n.a.

- o Secondly, while it is true that our proposed 1985 budget will take a larger share of the economy (23.8%) than the 1981 Carter budget (22.7%), as charged by Human Events, this point on overall spending ignores the reasons why. Again, defense and national interest programs had to be restored and will take 1.7% more of GNP. Likewise, debt service is up due to the big deficits and will take 0.6% more. By contrast, domestic spending will take 1.2% less even with the slight rise for automatic social insurance programs.

- o Thus, our higher figures on the Federal spending share of GNP have occurred not because we have pushed up domestic spending -- but because we haven't been able to pull it down fast enough to off-set the rising share for defense and debt service. It is, of course, fine to say that total spending should take a lower share of the economy than under Carter or even be under 20% as per our original targets. But unless we can get even faster growth of GNP than the present rapid pace without rekindling inflation or can make deep cuts in social insurance, this is not likely to happen. Since gunning the economy for several more years is almost certain to wipe out our victory over inflation and attempting deep cuts in social security and medicare could wipe out the Republican party, I believe we are going to have to accept a higher Federal spending share of GNP than we originally intended. Some education of our supporters along these lines will be necessary after the election:

BUDGET SHARE OF GNP: 1981 VS 1985

<u>Budget Component</u>	<u>1981 Carter</u>	<u>1985 Reagan</u>	<u>Change</u>
<u>Mandatory or Priority Components:</u>			
Defense	5.3%	6.3%	+1.5
National Interest	0.7%	0.9%	+0.2
Debt Service	2.4%	3.0%	+0.6
Subtotal	8.4%	10.7%	+2.3
<u>Domestic Components:</u>			
Social Insurance*	7.6%	7.8%	+0.2
All Other Domestic	6.7%	5.3%	-1.4
Subtotal	14.3%	13.1%	-1.2
<u>Total Spending</u>	22.7%	23.8%	+1.1
* Social Security, Medicare, Federal Pensions, Unemployment, Railroad Retirement and Black Lung			

HUMAN EVENTS CHARGE #3: PALTRY SAVINGS OF \$4.6 BILLION

"There is virtually no cost containment in this budget, with domestic savings a paltry \$4.6 billion. The big ticket items continue to climb. Social security will rise more than \$11 billion... (Medicare and Medicaid) will rise more than 13%, hovering near the \$100 billion mark... Onward and upward the budget goes."

- o All of these numbers are accurate. Our proposed FY 1985 savings of \$4.6 billion amount to less than a 1% cut from the built-in baseline for all spending except the Defense Department and debt service. However, there are a number of mitigating circumstances that HUMAN EVENTS may not be aware of:
 - o Because of the election, our hands were tied on 65% of the non-DOD budget. As shown in Category A, the built-in baseline for social security, medicare, veterans, unemployment and other large, sensitive programs is \$360 billion. Due to potential screams and demagoguery we have proposed essentially no 1985 savings in these programs except for minor medicare and federal retirement savings of the type Congress has previously endorsed.
 - o Another 13% of the non-DOD budget (\$73 billion) consists of programs we are trying to increase on policy priority grounds (space and security assistance) or which we have promised not to cut (general revenue sharing and the highway program). As shown in Category B, we are proposing to increase the baseline for these programs by \$5 billion. These add-ons offset savings elsewhere in the budget and reduce net savings to only \$4.6 billion.
 - o Thus, since we weren't in a position to achieve cuts in nearly 80% of the non-DOD budget (categories A&B), HUMAN EVENTS' point about "paltry" savings is a non sequitur.
 - o We are still proposing, however, many of our original deep cuts as shown in Category C. But these are generally small programs and the built-in baseline is only 10% of non-DOD spending. Thus, cuts averaging 10% per program yield only \$4.8 billion in savings.

- o The remaining \$65 billion in baseline spending (Category D) is for things like national parks, National Institutes of Health, health block grants, Census Bureau, vocational education, FDA, disaster relief, nutrition programs and the job training block grant. Most of these programs have been pared back substantially or are not susceptible to cuts -- so our savings amount to only \$2.9 billion or 4%.

<u>Budget Component</u>	<u>1985 Built-in Baseline</u>	<u>1985 Savings or Increase</u>
<u>Total Non-DOD Built-in Spending Baseline*</u>		
1) Total Non-DOD Baseline	\$549.6	-\$4.6
A) <u>Big Programs We Couldn't Touch in FY 1985</u>		
2) Medicare	69.1	-1.0
3) Social Security	188.3	0.0
4) Unemployment Insurance	18.3	0.0
5) Railroad Retirement	6.4	0.0
6) Federal Retirement	24.3	-0.8
7) Farm Price Supports	10.7	+0.1
8) Veterans Programs	26.1	0.0
9) Black Lung	1.7	0.0
10) Supplemental Security Income.	8.4	0.0
11) Refugee Aid	0.4	0.0
12) Handicapped Education and Rehabilitation	2.4	0.0
13) Head Start & Social Services Block Grant	3.8	0.0
14) Sub-total, Category A ..	359.9	-1.7
B) <u>Administration Priorities or Programs We Have Promised Not to Cut</u>		
15) DOE nuclear weapons, defense preparedness & stockpile ...	7.3	+0.7
16) Foreign aid & Central America	5.7	+1.0
17) State Department/USIA	3.0	+0.3
18) Space program	6.4	+0.3
19) IRS/Coast Guard/law enforcement	11.5	+0.2
20) National Science Foundation/ nuclear research	3.1	+0.1
21) Sewer grants/general revenue sharing	7.1	0.0
22) Community development & UDAG	4.4	0.0
23) Highway programs/FAA modernization	17.9	0.0
24) Sub-total, Category B ..	\$72.8	+4.9

* Also excludes debt service.

Budget Component	Built-in Baseline	1985 Savings or Increase
C) <u>Programs Proposed for Deep Cuts:</u>		
25) EDA, housing rehabilitation, urban parks	0.5	-0.1
26) Amtrak/Northeast Corridor	1.1	-0.1
27) Postal Service subsidy	1.0	-0.3
28) SBA/NOAA/GSA	2.5	-0.4
29) Medicaid	22.0	-1.1
30) AFCD/WIN/WIC	8.6	-1.2
31) Impact aid/physician training	0.9	-0.1
32) Student aid/higher education	7.4	-0.3
33) Legal Services, community action, weatherization	1.0	-0.6
34) Soil conservation/water projects	3.9	-0.4
35) Mass transit	3.6	-0.2
36) Sub-total, Category C ..	52.5	-4.8
D) <u>All Other Non-DOD Programs</u>		
37) Aggregate budget outlays	64.6	-2.9

HUMAN EVENTS CHARGE #4: EDUCATION & USDA HIGHER THAN CARTER

"...the Department of Agriculture will spend \$37 billion, up... more than \$11 billion above the level when Ronald Reagan entered office... the Department of Education which was supposed to vanish in a Reagan Administration, is seeking a record \$15.5 billion next fiscal year..."

- o In addition to pointing out the correct figures, Human Events may have scored a direct hit in these two cases because our 1985 budgets are indeed above Carter:

Department	1981 Carter	1985 Reagan	Amount of Increase (billions)	% Increase
Department of Education ...	\$14.9	\$15.4	\$+0.5	+4%
Department of Agriculture .	26.0	37.7	+11.7	+45%

- o In the case of USDA most of the increase is due to farm price support subsidies which have skyrocketed since 1981. Our basic mistake was that 12 months after we got here we signed a new farm bill for 1982-85 at the urging of farm state Republicans and Boll Weevil Congressmen who had helped us pass the 1981 budget and tax cuts and felt they deserved something in return. It turned out that the subsidies for milk, wheat, corn and cotton production were so large that vast surpluses have been generated and under the act USDA is obliged to buy them off the market. Consequently, during our first term farm subsidies, adjusted for inflation will cost 62% more per year than the average for 1962-1981. Our only answer is that we are determined not to repeat this mistake when a new 5-year farm bill comes up in 1985:

Farm Subsidy Costs, 1961-1985
(billions)

<u>Period</u>	<u>Average Annual Constant Dollar Cost</u>
1962-1976	\$8.1
1977-1981	6.1
1982-1985	12.3

- o Regarding the Education Department, we basically got trapped by a misunderstanding among our own supporters. Our original plan was to abolish the Department and cut the \$15 billion Carter 1981 Budget by nearly 50% -- to less than \$8 billion per year. However, when we began a campaign in behalf of local education reform last year in response to the Education Commission report, our Republican supporters in Congress thought we were abandoning our proposed cuts in Federal education funding. Led by Congressman Mickey Edwards (President of the American Conservative Union) a delegation came in during December, as you may recall, and insisted that we maintain the Department budget at or slightly above the level appropriated by Congress in 1984. It is possible that Human Events is not aware that this is the reason for the high Education Department figure in the FY 1985 Budget.

HUMAN EVENTS CHARGE #5: REAGAN SPENDING RECORD WORSE THAN CARTER

"The Reagan record in fact, is in many ways worse than the Carter record... looking at the two budgets the Reagan Administration is clearly responsible for -- FY 1982 and 1983 -- one finds that overall spending soared \$138.8 billion... [compared to] \$90.5 billion [during 1978-79 the comparable Carter years]... total, non-defense outlays during 1982 and 1983 shot-up \$86.4 billion; under Carter, non-defense expenditures went up \$71.4 billion."

- These figures are accurate, but they totally ignore three key differences between our first two years and Carter's:
 - During Carter's first two budgets the economy was in a roaring recovery with the unemployment rate dropping from 7.6% to 5.8%; in our case, the bottom fell out with unemployment rising from 7.5% to 10.7%. Consequently, unemployment outlays declined 33% in Carter's first two budgets, and increased 75% during ours.
 - During our first two budgets, the bottom fell out in the farm sector as well, causing farm subsidy costs to explode -- rising 374% in two years; during Carter's two years the farm sector was stable and subsidy costs actually dropped slightly.
 - Due to the high interest rates we inherited and the recession-swollen deficits during our first two years, debt service costs rose \$21 billion; during Carter's first two years they only increased by \$12 billion.
- As shown below, when you adjust for these factors which we couldn't control, our first two year record is better than Carter's:
 - overall spending excluding debt service, farm subsidies and unemployment increased 23% during Carter's first two years compared to 16% during ours;
 - non-defense spending excluding the three uncontrollables rose \$64 billion or 25% during Carter's first two years compared to \$39 billion or 9% during ours.

Comparison of Budget Growth Excluding Debt Service,
Unemployment and Farm Subsidies, 1978-79 vs. 1982-83
(billions)

<u>Two-year Comparison</u>	<u>Overall Budget*</u>	<u>Non-Defense*</u>
<u>First Two Carter Budgets:</u>		
o 1977 (base)	\$353	\$257
o 1979 (after two years)	434	321
o Two-year increase	+\$82	+\$64
o Percent increase	+23%	+25%
<u>First Two Reagan Budgets:</u>		
o 1981 (base)	\$567	\$413
o 1983 (after two years)	656	452
o Two-year increase	+89	+\$39
o Percent increase	+16%	+9%
* Excludes debt service, farm subsidies & unemployment		

II. REAGAN BUDGET SUCCESSES OVERLOOKED BY HUMAN EVENTS

- 1) We have already achieved 5-year domestic savings of \$318 billion compared to pre-Reagan baseline

<u>Year</u>	<u>Pre-Reagan Baseline</u>	<u>Savings Enacted</u> (billions)	<u>% Cut</u>	<u>% of GNP</u>
1982	\$489	\$-36	-7%	1.2%
1983	547	-60	-11%	1.9%
1984	565	-66	-12%	1.9%
1985	602	-70	-12%	1.8%
1986	641	-86	-13%	2.0%
5-year total	\$2,844	\$-318	-11%	1.7%
* Comparison based on budget costs under same economic assumptions. Includes off-budget outlays & savings.				

2) The runaway growth of low-income welfare programs has been stopped

- o After growing from \$6 billion to \$68 billion in constant dollars between 1954 and 1981, real welfare costs will remain flat at \$68 billion through the entire decade of the 1980's.

Constant Dollar Welfare Costs

<u>Pre-Reagan</u>	<u>Budget Cost</u>
1954	\$6.2
1970	20.8
1981	68.0

Since Reagan

1984	66.8
1989 proposed	68.4

Comparative Constant Dollar Growth Rates: Per Year

- o Welfare explosion period (1964-74) +14.4%
- o Reagan reform period (1981-89) 0.0%

3) The Great Society education, public jobs, health and social services and community action programs have been already cut 31% in constant dollars -- with savings rising to 47% by 1989 under the President's budget

<u>Year</u>	<u>Constant Dollar Budget</u>	<u>% Cut from Peak Year</u>
o 1979 peak funding	\$46.4	---
o 1984 enacted appropriation	31.9	-31%
o 1985 President's Budget	29.0	-38%
o 1989 President's Budget	24.8	-47%

4) After adjustment for inflation, Federal domestic spending rose 915% between 1954 and 1981. Due to our budget reforms it has declined 1% since 1981 and will remain frozen for the entire decade of the 1980's if our FY 1985 Budget is adhered to