BREAKING THE BUDGET IMPASSE

Last week's agreement between the White House and the Senate leadership marks a major step toward crafting a federal budget that will reduce the federal deficit significantly while redefining the role of the federal government. Much better than an across-the-board spending "freeze," which would have treated worthwhile and worthless programs alike, the compromise would eliminate many domestic programs that are little more than subsidies to powerful lobbies and others that can and should be handled at the state or local level. In return, President Reagan has accepted a significant cut in new spending for his plan to assure the nation's military security--a concession that will require tough Pentagon decisions on specific weapons systems and foreign policy questions.

The compromise would save $395 billion over the next three fiscal years. Of this, over $97 billion would come from cutbacks in projected defense spending, some $70 billion more in cuts than the President previously had been willing to accept. The total spending reductions would reduce the federal deficit to $100 billion by FY 1988. Given the economy's solid growth, plus the fact that state and local governments will enjoy annual surpluses amounting to $86 billion by 1989, the compromise means that total borrowing by the nation's public sector would fall significantly. Since such borrowing is the only real measure of government borrowing pressure on private investment and on interest rates, a drop in this borrowing invalidates any argument that a tax increase is needed to "solve" the deficit problem.

A critical feature of the White House-Senate leadership pact is that it eliminates programs that have no place in the federal sector. Over $10 billion a year would be saved by FY 1989, for instance, by ending several development assistance grants to states and cities, and by ending the misnamed Revenue Sharing program. In an era of deepening federal deficits and healthy state and local surpluses, these programs make little fiscal sense. Recent studies show, moreover, that most federal development programs such as Urban Development Action Grants create few new jobs. They merely shift around existing jobs while enriching development companies. And the $4.5 billion Revenue Sharing program provides federal largesse not only to communities in need, but to many of the nation's richest enclaves as well.

The 17 domestic programs slated for termination by the compromise include those that are wasteful or reward powerful or influential lobbies. Amtrak subsidies average $30 per journey per passenger, for instance, even though the typical rider has an income above the national average. The federally funded Ex-Im Bank, meanwhile, subsidizes major corporations; the Rural Electrification Administration still spends $3 billion a year, even though 99 percent of all farms now have electricity; and the Jobs Corps spends more training each participant than it would cost to send him or her to Harvard.

A total of $21 billion over three years would be achieved by limiting the cost-of-living adjustment in Social Security benefits to 2 percent below the inflation rate. This agreement reflects congressional concern that the rate of increase of Social Security benefits should be held down--the President has already made it clear that cuts in basic benefits are off limits. A further $18 billion would be saved by a freeze on hospital and physician charges and an increase in out-of-pocket charges for patients. This step would effect immediate savings in the federal cost of health care and spur competition throughout the health care industry by forcing hospitals and physicians to seek cost savings--to the benefit of all Americans.

These reductions in domestic outlays are accompanied by large cutbacks in projected defense spending. These cuts have long been sought by lawmakers, on the grounds that they are needed for a "balanced" or "fair" budget package. But this argument neglects two important points. First, if the federal system is to be rationalized, with the federal government concentrating on truly national aspects of policy and the states on more local domestic concerns, the balance of federal spending should shift to defense. In any event, the share of GNP allocated to defense is still well below the figure during the Kennedy presidency. Second, the requirements for defense are determined more by the Kremlin than by the Pentagon. As Britain learned during the 1930s, sacrificing security to relieve pressure on domestic programs can be a very costly way of saving money.

Reagan's agreement to limit defense spending to 3 percent real annual growth is a major and risky concession to achieve compromise. Congress should not deliver these cuts by cancelling essential weapons systems and by reducing readiness. Instead it should take such steps as closing down unessential bases in key districts and instituting sound management systems in the procurement process. The Administration's pact with the Senate leadership is a bold and important breakthrough in what had seemed to be a budget impasse. By accepting a reduction in its defense request, the White House is trusting Congress to deliver domestic cuts and to make sensible economies in defense.

Stuart M. Butler
Director of Domestic Policy Studies

For further reading:

Stuart M. Butler and Stephen Moore, "A Guide to the Reagan Budget," Heritage Foundation Backgrounder No. 408, February 11, 1985.

Stuart M. Butler, ed., Taming the Budget (Washington, D.C.: The Heritage Foundation, 1985).

Peter J. Ferrara, "For Revenue Sharing, Time Has Run Out," Heritage Foundation Backgrounder No. 417, March 13, 1985.

Peter Ferrara, "Time to End Wasteful Urban Development Grants," Heritage Foundation Backgrounder No. 419, March 26, 1985.