OUTLINE OF REMARKS

BOSTON PRESS SEMINAR

FEDERAL BUDGET DEFICITS AND ECONOMIC GROWTH: ARE THEY COMPATIBLE?

I. Prognosis

We have to realistically assess the state of the economy and the prospects for the next few years. The fact is that the groundwork has been laid for a stable and lasting recovery, without renewed inflation. It is absolutely crucial that we proceed with care at this point, and not throw away the gains already made.

No one should doubt that we are making progress. In January the index of leading economic indicators jumped 3.6 percent--the biggest one-month rise since 1950, and the ninth increase in the last 10 months. The index rose another 1.4 percent in February. In addition, the "concurrent indicators" of current economic performance rose .6 percent in January, showing we are in recovery.

Right now the most important thing we must do is judge carefully the degree of stimulus the economy can and should take, consistent with a firm anti-inflation policy. The Federal Reserve will play a key role, and has already shown a willingness to adjust its short-term goals based on an assessment of the weakness of the economy. We will not allow the recession to continue, but we will not reinflate the economy, either.

II. <u>Approach to the Deficit Problem</u>

The fact is that all our economic difficulties are related--high interest rates and slow growth boost the deficit, and higher deficits create greater uncertainty in the business community as to our future course; will there be more inflation, or less credit available for business expansion?

Because of this, it makes sense first of all to chart a path that is most likely to bring stable growth without inflation. Higher growth boosts revenues and cuts unemployment costs, thereby reducing the deficit as well: already, upward revisions of growth estimates are being made in light of the economic indicators. The administration originally expected 3 percent growth this year--now they anticipate 4.7 percent. According to Martin Feldstein, this could cut $10 billion out of the 1984 deficit.

In the short term, as the President urges, it makes sense to continue to review every part of the Federal budget in an effort to bring the deficit down. This means both defense and entitlements must be under scrutiny to maximize the efficiency of every dollar spent. A <u>balanced</u> deficit reduction program is our goal.

Continued efforts to restrain the deficit by controlling Federal spending will give the Federal Reserve a bit more room to accommodate the potential for real growth that exists in the economy without inflationary pump-priming. But restraint in both fiscal and monetary policy is crucial if we want to maintain long-term confidence in the economic program. That means long-range goals must be carefully reconciled with efforts to respond to particular weaknesses in the economy. Radical attempts to reverse course would be self-defeating and must be resisted.

III. The House Budget

We all know that developing a credible, deficit-reducing budget for 1984 and beyond is going to take a lot of hard work and give and take on all sides, Democrat and Republican, liberal and conservative. The President has made his proposal, and the House has adopted a radically different alternative. We are likely to end up with something in between, but we ought to consider for a moment who is closer to the mark in terms of the vital needs of our economy and in terms of national priorities.

The House-passed budget resolution, engineered by the Democratic leadership, simply is not a credible plan for meeting our priorities and achieving sustained economic growth. The House recommends a $30 billion tax increase in FY 1984 alone. That is not only an unreasonable increase in the tax burden as we come out of a recession, it can only mean that House Democrats want to repeal the third year of the tax cut for the working people. Reneging on promises is no way to run the government, and that proposal must be rejected. Even the members of the House Ways and Means committee have expressed strong doubts that any more than $8 billion in revenue can or should be raised in 1984.

Defense spending. The President has recommended a 10 percent real increase in defense spending, and the House resolution on its face, recommends a 4 percent increase. But if you cost out the House defense figures to make them properly comparable to the administration's estimates, you see that the House recommends a mere 2 percent increase in defense as against the President's 10 percent. This is due to different assumptions about current spending and military pay. We all know that defense, like every area of the budget, will have to assume a fair share of the burden of deficit reduction. But surely we ought to take more seriously the President's concern about our national strength vis-a-vis the Soviet Union. We can and probably will have to modify the President's defense request, and the President will have to deal with both the Senate and the House leadership if we are to get agreement. We do have to get more out of each defense dollar spent. But the House-proposed increase is not wise, reasonable, or in the national interest.

Domestic spending. There is widespread agreement that we cannot let the burden of deficit reduction continue to fall on benefits for lower-income Americans. But that does not mean domestic spending is untouchable--it can and must be reduced, something the Democratic budget fails to acknowledge. The House resolution provides $25 billion more for nonmilitary spending than does the President's budget. $6 billion of that difference is in the health area: and certainly we have reached the point where we should acknowledge that Federal health program costs are not under control, and that changes to control costs are very much in order. The American people do want to share the cost of reducing the deficit in a fair way. But they do not want national security risked, or the tax burden on individuals raised to an unconscionable degree, just because some members of Congress do not want to reexamine programs that may have outlived their usefullness or have become grossly inefficient. Instead, let us work together, and with the President, to reach a bipartisan agreement like that worked out on social security.

IV. The Budget: Tax Issues

There are lots of ways to raise revenue, but our job is to choose ways that are fair and consistent with good tax policy. We should resist the temptation to undo the progress that has been made in providing greater incentives for savings, work, and investment: those incentives will become more important as recovery proceeds. There are many base-broadening measures still to be considered that would improve the equity and efficiency of the tax code.

Indexing. The House budget assumes repeal of the tax indexing provision of the 1981 tax act, which takes effect in 1985. We all know that we have to compromise to get things done, but this is one area that we ought to leave alone if we are interested in sound tax policy and honesty in government. We can raise revenues--but why resort once again to back-door revenue increases generated by inflation? Tampering with indexing further risks sending a signal that we are prepared to reinflate the economy and generate revenues through bracket creep to deal with the deficit. That would mean undoing all the progress we have made over the past two years, and it would be a tremendous mistake.

Outyear tax increases. The President's budget recommends a contingency tax to raise $46 billion in FY 1986, consisting of a 5% surcharge and an oil tax, to be triggered if the deficit remains too high despite adoption of major spending cuts. It is not clear why we would need to use a "trigger" device to raise taxes based on deficit levels. It seems unlikely that a "trigger" mechanism would create the kind of reassurance on the deficit that the country is looking for.

If growth and revenues turn out better than now projected, we can always reduce taxes to the extent that becomes fiscally desirable. One possibility is to enact some additional base-broadening measures--improvements in equity and eliminating tax provisions that are economically inefficient--then provide for further rate reductions if the deficit is brought under control more rapidly than is now expected. This would maintain the momentum for a lower-rate, broader-based tax system that has been built over the last two years. It is also consistent with the administration's consideration of a streamlined and simplified tax structure with lower rates.

Revenues and the Deficit Problem

You can't really decide whether the tax burden is appropriate until you look at the scope of Federal spending and the obligations our people expect us to fulfill. The fact is that in 1981 Federal taxes as a percent of Gross National Product reached a peacetime high of 21 percent, and it is only the combination of the Reagan tax cuts--and the recession--that has brought the proportion down to 18.7 percent this year. Receipts as a proportion of GNP averaged 18.8 percent between 1960 and 1979, and the current proportion will rise as the economy recovers. The current Federal tax burden then, is much more in line with recent history than it was under the Carter administration.

Those who say the tax burden is too low believe the American people are too accustomed to Federal spending at present levels--about 25 percent of GNP--and doubt our ability to reduce spending. But spending can and must be reduced further by reviewing all areas of the budget, including entitlements and defense. Still, it will also be necessary to look at revenues to narrow the budget gap, because building a consensus on spending reductions takes time and a willingness to compromise. So while taxes are not too low, it is fair to say that we could do a better job of exploiting our present tax base: there are too many special preferences, deductions, exemptions, and credits in the tax code. So-called tax expenditures are estimated to cost the Treasury about $296 billion in FY 1984.

Conclusion. Clearly deficits at the levels now projected if we do nothing--around 7 percent of gross national product, and declining only slightly in the late 1980's--are incompatible with sustaining an economic recovery, even if they do not threaten economic growth in the short term. Both the President and the House leadership recognize this, and both have put forward budgets that would drop the deficit below 4 percent of GNP by 1986, and lower still in subsequent years.

The real issue, then, is not whether oversize deficits are incompatable with sustained growth, but over what steps--or what combination of measures--offer the best hope for cutting the deficit without interfering with other incentives for growth in the areas of tax, trade regulation, and monetary policy. This is where the Senate will play a crucial role, in helping to sort out priorities, insuring the maintenance of a strong but fiscally feasible defense program, and holding the line on domestic spending more effectively than the House is inclined to do. Now that the economy is poised for expansion, neither excessive deficits nor retreat from our fundamental economic gains can be allowed to block the way. That is the challenge facing the Congress.