Stockman builds political scaffold for Reagan

by David Goldman

President Reagan's Feb. 19 budget message to Congress is a well-crafted political trap. On paper the budget reduction program is indistinguishable from the April 1979 program of British Prime Minister Margaret Thatcher, and will have the same murderous consequences for the traditional supports for the U.S. economy that the Thatcher program did in the U.K. But the short-term significance of the President's gigantic, avoidable blunder is to give the "British" faction in his administration the chance to break him on the anvil of opposition in the Democratic-controlled House of Representatives.

Under the implied scenario, Federal Reserve Chairman Paul Volcker will become de facto economic czar, preempting the negotiations of the executive and legislative branches of government through "independent" use of monetary policy. The President's worst error was to recognize the Fed as a virtual fourth branch of government:

"Now we fully recognize the independence of the Federal Reserve System and will do nothing to interfere with or undermine that independence. We will consult regularly with the Federal Reserve Board on all aspects of our economic program and will vigorously pursue budget policies that will make their job easier in reducing monetary growth."

The bottom line of this concession is $30 billion of budgetary red ink. Volcker's current monetary stance implies interest costs on the nearly $1 trillion national debt of more than $20 billion per annum in excess of the previous year's—and considerably more than that, compared to debt service following the right kind of monetary stabilization. Additional depression-related costs, including mostly social insurance items, bring the total cost of capitulation to the Federal Reserve to over $30 billion.

Stockman's axe fell most heavily on the capital-improvement features of the federal budget, i.e., the portions of federal spending which most contribute to future economic growth and productivity. Worst hit are energy R&D, the space program, agriculture, inland transport, and infrastructure generally.

The cuts include:

- A 20 percent reduction in highway building;
- A 33 percent reduction in airport construction;
- A 20 percent cut in water projects (from the already truncated level Carter had proposed);
- An initial 6 percent cut in the National Aeronautics and Space Administration budget, becoming (under the projections) a worse than 50 percent after-inflation cut by 1985;
- A 30 percent, or $2.1 billion, reduction in Eximbank authorizations for the next two fiscal years, endangering about 100,000 industrial jobs;
- A $100 million reduction in Farmers Home Administration loans, which will accelerate the more than 1,000 per week rate of farm abandonments;
- A 64 percent reduction in price supports for the dairy industry, undermining the one agriculture sector where parity price supports have succeeded in maintaining relatively stable prices;

• $2 billion in "users' fees" for the use of federally built inland waterways and airports, raising the cost of inland transport—against every principle of industrial economics.

On the positive side of the ledger, the Reagan program does, in fact, throw out substantial waste, including $500 million in synthetic fuel grants; 60 percent of Carter's proposed $583 million in solar energy subsidies, and virtually the entire array of "soft energy" programs offered by the Carter Department of Energy, including small hydro-electric plants, conservation and environmental studies, "gasohol" subsidies, and geothermal energy.

However, the net result of Reagan's cuts in the capital account of the Federal budget is disastrous. The one area that has not yet been specified is the high-technology energy research and development program. Energy Secretary Edwards cancelled a Feb. 19 press conference because the budget allocations for these programs were still under negotiation.

Contrast this to the budget crisis program which the great French economist Jacques Rueff prepared for President de Gaulle of France at the peak of the 1958 national crisis, in the midst of a budget and currency disaster several times worse than anything Reagan faces. Rueff managed to increase capital-account investment by 28 percent in real terms in a single budget year, by convincing the French nation to finance a deficit arising from spending on behalf of greater industrial productivity.

The combination of high interest rates and truncated federal support for the traditional means of improving heavy-industry productivity—of which the inland-transport users' fees are the most egregious—will ruin American heavy industry. Last November, former German Bundesbank President Otmar Emminger warned that American industry could not survive six months at the then- and still-prevailing interest rate level. Industrial construction, auto, steel, housing, and other basic industries will not be able to use the accelerated depreciation tax breaks offered by the President, for the simple reason that they will not be able to obtain the capital for investment purposes in the first place!

In itself, the Reagan tax program's 10-5-3 (10-year depreciation schedules for structures, 5-year depreciation for equipment, and 3 for vehicles) formula is crude, but more effective than the frankly Benthamite approach of the "supply-side" Kemp-Roth bill. The latter bill assumes that the combination of lower marginal tax rates and tight money will magically increase producers' will to produce, and generate more wealth out of the sharpened motivation to earn more. In fact, since the supply-side program assumes the elimination of new credit generation, it means that those industries with high cash flow, or advantageous relative price positions, take the entire cake.

Nonetheless, Reagan's departure from the doctrinaire supply-side tax formula is more than outweighed by the composition of budget cuts. The industries who will enjoy the benefits of the depreciation plan include military producers, electronics, telecommunications, and business equipment. The industries who will not include auto, steel, chemicals, rubber, and construction.

The first blasts of oppositon to the Reagan plan came from the Feb. 18 meeting of the AFL-CIO's executive board, and from the House and Senate Democratic leadership. The AFL-CIO cited the expected cuts in social programs and warned that it would "do battle" with the administration over income-support reductions. House Speaker Tip O'Neill said to reporters, meanwhile, "You bet there are inequities," while Democratic Senate leader Robert Byrd warned of an alternate tax package.

The budget's income-maintenance cuts powerfully affect some of the strongest, and worst-aggrieved, constituencies in the country. The $1 billion per year in trade-adjustment assistance Reagan proposes to eliminate forthwith is now an indispensable source of income to 300,000 unemployed auto workers, whose supplemental unemployment benefits and regular unemployment insurance benefits are now running out after a year of unemployment. Most of these unemployed auto workers responded to the President's frank and direct appeal during the campaign, and voted for him. Now over 10 percent of the population of the State of Michigan is on welfare—one of the most industrialized states in the nation reduced to the demographic condition of New York City! The trade-adjustment assistance cuts would mean brutal hardship for the layer of the workforce with the biggest set of grievances against Carter economic policy. The leadership of the United Autoworkers Union, meanwhile, is committed to the Second International strategy to destabilize the Reagan administration.

In addition, the $4 billion the administration proposes to save by phasing out the Comprehensive Employment and Training Act promises to induce several hundred thousand layoffs in cities already operating at the edge of budgetary disaster (see Economics on the Boston situation). The CETA program itself is, undeniably, one of the worst-designed and most wasteful programs in the budget, but it provides a prop for a section of the economy that cannot afford to lose it at this point.

These legitimate grievances, and those of farm and other constituencies threatened by the Stockman cuts, will make the deliberations on the Democratic House side of Congress murderous. Reagan faces, rather than the swift action he wants, protracted trench warfare admidst a worsening depression—the worst of all possible political worlds.