Where to cut—where not to cut

by Richard Freeman

In his nationally televised economic address Feb. 5, President Reagan sounded the note of an industrial revitalization, and simultaneously made key omissions and proposals that could undo the economy and his presidency. Reagan declined to single out the destructive effects of the Federal Reserve chairman's interest-rate policy. He also endorsed a variety of budget cuts, including cuts in the Export-Import Bank, the nuclear fusion program, and the National Aeronautics and Space Administration (NASA), which would gut American productivity.

At issue in the President's speech is the direction of the U.S. economy, not only for the next four years, but for the next couple of decades. Thus the forthright commitment to economic growth expressed in the Feb. 5 speech requires an end to muddleheadedness on monetary and fiscal matters. As I reported last week, Paul Volcker's interest-rate policy has added at least $30 billion to the 1981 fiscal budget deficit, including $22 billion in interest payments on the public debt, plus increased outlays for unemployment benefits, as well as lost tax revenue. These Volcker tack-ons to the budget gap should be the first target of the administration's cut list.

Calamities and proposals

Reagan began his address with the following assessment: "I regret to say that we're in the worst economic mess since the Great Depression. . . . Today, this once-great industrial giant of ours has the lowest rate of gain in productivity of virtually all the industrial nations with whom we must compete in world markets. . . ." The President proposed a package of accelerated depreciation tax breaks on investment in new plant and equipment, and removal of the most onerous environmental restrictions. "We have to give [American workers] the tools and equipment that workers in other industrial nations have. . . . We must increase productivity. That means making it possible for industry to modernize and make use of the technology which we ourselves invested; that means putting Americans back to work," he said.

The other side of the speech, the budget-cutting side, was virtually dictated to the President by the monetarist core within the administration, led by Office of Management and Budget (OMB) Director David Stockman and Treasury Undersecretary for Monetary Affairs Beryl Sprinkel. Last week saw the appointment of Lawrence Kudlow as the senior assistant and chief economist at OMB. Kudlow, formerly the chief economist at Bear, Stearns investment bank, served under Volcker for three years when Volcker headed the New York Federal Reserve. "At a meeting at OMB last weekend," Kudlow's colleague at Bear, Stearns, Robert Synch, reported Feb. 5, "Stockman and Kudlow and others worked out a unified package of tax and budget cuts with monetary restraint, and they will bear down on the President to adopt it."

The effect was evident in Reagan's speech and in the fact sheet presented by the President's staff at the time of the speech. Reagan stated that budget deficits are the major cause of inflation—they are not—and proposed cuts which his fact sheet says would total $15 billion in fiscal 1981 and $40 billion in fiscal 1982, many of them highly destructive.

For fiscal 1981, what is proposed includes:

- 20 percent from the nuclear fusion budget;
- 25 to 40 percent from the Export-Import Bank;
- several billion dollars through the elimination of CETA jobs, reduction or elimination of unemployment benefits for those out of work for over 26 weeks, and sharp cuts in trade adjustment assistance for autoworkers;
- cancellation of NASA's Galileo mission scheduled to probe the atmosphere of the planet Jupiter.

Reagan proposed many other cuts in the same vein. On Feb. 10 he reversed some of the proposals, stating that there are seven programs, totaling $210 billion in fiscal 1981, that benefit the elderly and very poor, and would not be cut. These include the $140 billion Social Security old age and survivors' insurance program, which serves 32 million retired workers who paid into the system, and the $45.4 billion Medicare health program for 28.6 million elderly recipients.

Whether Congress will permit major cuts in spending for NASA, the fusion budget and the Eximbank is doubtful. But meanwhile, at 19 percent interest rates, inflation will persist and accelerate, while funds flow into the high-return, nonproductive sectors of the economy, further fueling inflation. As long as Volcker receives even grudging support from the White House, no economic recovery is possible. Moreover, an unbalanced budget adds at most one or two percentage points to the current 13 to 15 percent rate of inflation. Cuts in scientific, technological, and educational outlays will simply compound the U.S. productivity crisis, and thus earn the President the enmity of the population and the paralysis of our 1980s economic potential.