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AN ANALYSIS OF THE REAGAN ECONOMIC PROGRAM

INTRODUCTION

President Reagan's economic program, unveiled February 18, is remarkably consistent in both its practical and philosophical reliance on the free market. The tax package, based on the belief that individuals and corporations will respond to altered incentives, does not attempt to channel resources into favored activities, but instead relies on the market to direct the funds to the highest uses. Many of the spending cuts were advanced to eliminate or reduce federal programs which are properly in the province of the private sector: for example, the Export-Import Bank, Amtrak, the synthetic fuels program. Following a dictum of Adam Smith, the Administration also advocates reducing federal spending $2 billion by assessing users fees for inland waterways airports and Coast Guard services.

A more subtle, but equally important affimation of the market is the Reagan Administration's decision to take a longer term perspective. The taxing and spending powers of the federal government will not be used in attempts to counter short-term economic fluctuations. Rather, the intent is to create a climate in which the government minimizes the distortionary effect of tax and spending, regulatory, and monetary policies on economic decision-making.

There are essentially two avenues of criticism of the Reagan proposals. The first is that the shift in perspective is ill-advised. Opponents would argue that traditional demand management policies are both adequate and necessary. Due in part to the dismal economic performance of the 1970s, this view is held by a rapidly dwindling minority. The position taken in this paper is that the private sector is inherently stable and that the longer term perspective is the correct one.

The second major area of inquiry concerns the composition, mix, and timing of spending and tax cuts. At issue are: 1) specific elements of budget and, more particularly, tax cuts and 2) the relative strength of the two forces, their effect on the deficit, and its effect on the economy. This paper addresses these questions.

THE REAGAN PROGRAM

President Reagan calls for FY 1982 outlays of $695.5 billion, receipts of $650.5 billion and a $45 billion deficit. Included within these aggregates are $41.4 billion in spending reductions, $53.9 billion in individual and corporate tax cuts, and $2 billion in proposed users fees. Another $5.7 billion in off-budget cuts are outlined.

The program also contains $4.4 billion in current fiscal year budget cuts and $8.9 billion in tax cuts. Fiscal year 1981 spending would total $654.7 billion with a $54.5 billion deficit.

Table 1
CURRENTLY ESTIMATED BUDGET OUTLOOK
WITH PRESIDENT'S BUDGET SAVINGS AND TAX REDUCTION PROGRAM
(dollar amounts in billions)

	1981	1982	1983	1984	1985	1986
Target outlay ceilings	654.7	695.5	733.1	771.6	844.0	912.1
Estimated receipts after tax reduction plan	600.2	650.5	710.2	772.1	850.9	942.0
Target deficit (-) or surplus	-54.5	-45.0	-22.9	+0.5	+6.9	+29.9
Share of GNP						
Outlays	23.0	21.8	20.4	19.3	19.2	19.0
Receipts	21.1	20.4	19.7	19.3	19.3	19.6

It is not correct to compare the Carter Administration's FY 1982 budget numbers, submitted in January, with the Reagan proposal because the latter was based on decidedly more optimistic economic assumptions. The variance in forecasts affects the base from which the changes are calculated.

Because the Reagan program depends so much on supply-side tax cuts and changes in expectations, concepts which are overlooked or more difficult to measure in most econometric models, there was some disagreement within the Administration about the impact of the economic package. In a compromise, the forecast anticipates real growth rates of 4.2 percent, 5.0 percent, 4.5 percent, 4.2 percent, and 4.2 percent from 1982 through 1986. The consumer price index will fall from 11.1 percent this year to 8.3 percent in 1982 and 6.2 percent in 1983.

Table 2
ECONOMIC ASSUMPTIONS
(Calendar Years)

	1981	1982	1983	1984	1985	1986
Nominal Gross National Product (billions)	$2,920.0	$3,293.0	$3,700.0	$4,098.0	$4,500.0	$4,918.0
(Percent Change)	11.1	12.8	12.4	10.8	9.8	9.3
Real Gross National Product (billions, 1972 dollars)	1,497.0	1,560.0	1,638.0	1,711.0	1,783.0	1,858.0
(Percent Change)	1.1	4.2	5.0	4.5	4.2	4.2
Implicit Price Deflator	195.0	211.0	226.0	240.0	252.0	265.0
(Percent Change)	9.9	8.3	7.0	6.0	5.4	4.9
Consumer Price Index* 1967 = 100	274.0	297.0	315.0	333.0	348.0	363.0
(Percent Change)	11.1	8.3	6.2	5.5	4.7	4.2
Unemployment Rate (Percent)	7.8	7.2	6.6	6.4	6.0	5.6

*CPI for urban wage earners and clerical workers (CPI-W).

ANALYSIS

The following analysis will be divided in two parts. The first will be an examination of the program elements designed to alter the economic incentives to work, save, and invest. These consist primarily of tax cuts and changes in programs, such as unemployment insurance and trade adjustment assistance. The second portion of the analysis will focus on the proposed spending cuts, their efficacy, and completeness.

ECONOMIC INCENTIVES

The Tax Proposal

President Reagan's tax proposal is a sweeping plan to return much economic decision-making to the purview of the free market. The proposal differs from tax cuts of recent years in that it is not aimed at stimulating aggregate demand through changes in the average tax rates. Rather, it is designed to increase work, savings, and investment through changes in the marginal tax rates. The general philosophy behind this type of tax cut is that the many artificial relative price distortions make it better to lower marginal rates and decrease all biases rather than attempt to chip away structurally at each one individually.

If the plan is adopted, marginal tax rates for personal income will be cut by 5 percent, starting on July 1, 1981. In 1982 and 1983, these will be cut by an additional 10 percent per year, and in 1984 the plan calls for a final 5 percent cut.

There was debate as to whether the maximum tax on unearned income should be dropped immediately from 70 percent to 50 percent. Due to political circumstances, the decision was made not to effect that change immediately. However, when the plan is fully implemented, marginal tax rates will range from 10 percent to 50 percent.

Table 3
THE ADMINISTRATION'S PROPOSED TAX RATE SCHEDULES
FOR 1981, 1982, 1983, AND 1984

JOINT RETURNS

Taxable income bracket	Present Law	Administration Proposal			
		1981	1982	1983	1984
	Tax Rate on income in bracket	Tax Rate on income in bracket	Tax Rate on income in bracket	Tax Rate on income in bracket	Tax Rate on income in bracket
(dollars)	(percent)	(percent)	(percent)	(percent)	(percent)
$ 0 - 3,400	0%	0%	0%	0%	0%
3,400 - 5,500	14	13	12	11	10
5,500 - 7,600	16	15	14	12	11
7,600 - 11,900	18	17	15	14	13
11,900 - 16,000	21	20	18	16	15
16,000 - 20,200	24	23	21	19	18
20,200 - 24,600	28	27	24	22	21
24,600 - 29,900	32	30	27	24	23
29,900 - 35,200	37	35	31	28	27
35,200 - 45,800	43	41	37	33	32
45,800 - 60,000	49	47	42	38	36
60,000 - 85,600	54	51	47	42	40
85,600 - 109,400	59	56	50	45	43
109,400 - 162,400	64	61	55	49	47
162,400 - 215,400	68	65	58	52	49
215,400 and over	70	66	60	53	50

The depreciation proposal is a slightly revised version of the Capital Cost Recovery Act of 1979, introduced by Congressmen Barber Conable (R-New York) and James Jones (D-Oklahoma). Under the President's plan the useful life concept is scrapped and the following categories and write-off periods would be established.

	Category	Write-off Periods
o	Automobiles and light trucks	3 years
o	R & D capital	3 years
o	All other machinery	5 years
o	Public utility capital with a previous guideline life of under 18 years	5 years
o	Owner-occupied non-residential structures	10 years
o	Public utility capital with previous guideline life of over 18 years	10 years
o	Other non-residential structures	15 years
o	Low income rental housing	15 years
o	Residential rental buildings	18 years

The 3-, 5-, and 10-year categories qualify for a super-accelerated write-off method involving an optimal combination of the "double declining balance" and "sum of the years digits" methods of depreciation. The 15- and 18-year categories must use "straight line" methods.

The 3-year category qualifies for a 6 percent Investment Tax Credit (ITC) and the 5-year category qualifies for a 10 percent ITC as does public utility capital in the 10-year category.

Structures in the 10-year category are considered to be section 1245 property for purposes of recapture, but the 15- and 18-year categories are considered to be section 1250 property. This permits the latter two categories to be subject to some capital gains taxation, as opposed to ordinary income taxation at the point of sale.

The Individual Cuts

The distinction between personal and business cuts is an artificial one. Individuals own all businesses and all business income accrues to individuals in one form or another. Thus, any tax change that affects personal saving affects businesses and any business tax cut will have an effect on personal well being.

The current tax code contains serious distortionary factors which lead to efficiency losses to society. Because of its multiple taxation of income from personal saving, the tax system creates a bias in favor of consumption and against saving. Less saving means less investment, which hampers economic growth.

High marginal tax rates on labor income artificially penalize the work effort. Once again, this causes an efficiency loss to society because the cost of working relative to leisure or non-market activity is distorted.

All economic decisions are made at the margin. That is, a worker makes his decision to work or not to work based on the tax treatment of additional dollars of labor income, not on the treatment of dollars earned in the past. If relative prices are distorted, it is only through changes in marginal tax rates that the distortions will be minimized.

What will the 30 percent across-the-board cut in marginal rates accomplish? Since the price of labor relative to leisure is exactly the after tax real wage rate, a cut in marginal tax rates on labor income will increase the marginal wage rate, thereby making work more profitable and leisure more costly.

The proposed individual cuts also indirectly attack the anti-saving bias in the tax code. In a manner similar to the effect on the work-leisure choice, the cuts in marginal rates will advantageously affect the save-consume decision. For example, the present tax rate on income from savings for a joint return of $10,000 is 54 percent. By 1984, that will be reduced to 40 percent. Thus, for each one hundred dollars of savings incurred, the individual will retain an additional 14 percent.

Distortions, however, will still exist. There is still a multifold taxation of income from capital, including the taxation of interest income, dividends, and capital gains. Since the top marginal tax rate will be 50 percent, some of these distortions may be sizable.

A private investor in this bracket is taxed at the rate of 50 percent on new income. If he decides to invest some of his after-tax dollars, the return on his investment will also be taxed at the rate of 50 percent. Thus, the inherent bias against saving and investment continues, albeit at a diminished rate.

The individual cuts proposed by President Reagan are a good step in the right direction. Much more, however, remains to be done. Had the maximum tax on unearned income in the proposal been dropped immediately to 50 percent and had the reductions proceeded from there, the effects would be more positive.

<u>The Depreciation Program</u>

The President's proposed depreciation system is very close to being an ideal system. It accomplishes two things: 1) it lowers the overall marginal tax rate on income from capital, and 2) it removes a very serious bias against investment in long-lived assets. Further, it diminishes much of the complexity and administrative burden associated with the present depreciation system.

By allowing firms to recover their capital more quickly, tax payments are deferred. Thus, the discounted value of these tax payments is lessened. For the same reason that double taxation of personal saving is distortionary, high marginal tax rates on the income from physical capital is distortionary. The current tax treatment poses a relative disincentive to investment in physical capital. Only the immediate expensing of capital assets will provide a climate in which investment decisions will be made irrespective of the tax system -- the desired, "neutral" result. Given political realities, the President's depriciation proposal approximates this desired neutrality.

It is firmly established in the economic literature that businesses are quite responsive to changes in marginal tax rates on income from capital. As a result of the new depreciation system we can expect new investment in productive, physical capital. A second major efficiency gain will come from the removal of a present-law bias against certain types of capital.

A major distortion that exists in the current tax code is the bias towards investment in short-lived assets at the expense of long-lived assets. By clinging to the "useful life" concept, present law insures that the relevant price of a long-lived asset relative to a short-lived asset is higher than would be the case in a non-tax world. This factor has contributed to a tax-induced shift of resources in our economy. It cannot be claimed that all the woes of the steel industry, for example, are to be blamed on this distortion, but certainly it has been a contributing factor.

This obsession with the useful life concept stems from the belief that depreciation for tax purposes must be matched with actual economic depreciation or the loss of value an asset suffers per accounting period. The traditional wisdom holds that such a system would be neutral with respect to assets of differing durabilities. Recent, more sophisticated analysis has shown that in the context of developments over time, the traditional wisdom is false and in fact discriminates against long-lived assets.

The proposed depreciation system will return the relative positions of short- and long-lived assets to their proper place. No longer will there a tax-induced incentive to favor investment in short-lived assets.

Critics argue that the Reagan tax proposal, by returning so much money to the private sector, will create a demand pull inflation. However, inflation occurs only if the rate of growth in the money supply exceeds the rate of growth of goods and services. Therefore, we need only worry about inflation if whatever deficit exists is funded through monetary expansion by the Fed. As long as the Fed holds the line and follows a rational, steady, monetary policy, there will be no inflationary effects. The Reagan program specifies a desire for a gradual reduction in the money supply and credit growth rate to one-half the current levels by 1986.

The Administration also has indicated its support for the Federal Reserve policy of targeting money aggregates rather than interest rates. With deficits of $54.5 billion in FY 1981 and $45 billion in FY 1982, critics charge interest rates will skyrocket, thereby negating the beneficial effects of the tax cut.

The unprecented change in the tax treatment of all forms of savings will, however, clearly increase the supply of loanable funds. Treasury Secretary Regan has estimated that as much as two-thirds of the tax reduction will be saved. The demand for loanable funds will also increase. It is possible that there might be some initial pressure on the capital markets. It should be noted that as interest rates rise, saving will become more attractive.

As new productive capacity comes on stream, output will expand and real interest rates will stabilize. Of course, if government spending is successfully cut, there would not be any initial pressure in capital markets. The best way to guard against any short-run increases in interest rates is to be vigilant on the spending side.

UNEMPLOYMENT COMPENSATION

Unemployment compensation has been designed to replace approximately 50 percent of a worker's former average weekly wage. The Federal-State Extended Unemployment Act of 1970, enacted to give additional assistance to unemployed workers during periods of high state or national unemployment, authorizes the extension of benefits at the regular weekly amount for an additional 13 weeks whenever the unemployment rate among insured workers (IUR) rises above some state or national "triggering" level. The state trigger takes effect when the state's IUR equals or exceeds, for a 13-week period, 120 percent of the average rate for the corresponding period in each of the previous two years and when such a rate is also at least 4 percent. A state also has the option to extend benefits if the state's overall unemployment rate is at least 5 percent for 13 weeks. When the national IUR reaches 4.5 percent, the national trigger is "on," and all states, even those with relatively low unemployment rates, become eligible for the extended benefits.

Unemployment compensation often has the adverse effect of making layoffs desirable for both employees and employers. Generous benefits and added leisure time often create significant work disincentives. An employer may be induced into laying off more workers during an economic downturn than he otherwise would because the tax used to finance unemployment compensation is not always directly related to the unemployment experience of the firm. The extended benefits program adds to these distortions and generates even greater inefficiency.

The Reagan Administration has proposed restructuring the extended benefits program so that it would provide relief only to those areas plagued by high unemployment. The changes suggested are meant to achieve results analogous to tax cuts -- to restore work incentives by making employment relatively more attractive than unemployment. Specifically, the Administration's proposal would: 1) eliminate the national trigger; 2) change the way the state triggers are calculated; 3) raise the state trigger level from 4 to 5 percent of the IUR and, at state option, to 6 percent of the overall unemployment rate; and 4) strictly enforce the new rule requiring claimants to accept any reasonable job offer. Employment will be considered acceptable if it pays at least the minimum wage and can replace the individual's current unemployment insurance benefits. The first two changes will become effective July 1, 1981, while the third change would take effect only on October 1, 1982, thereby allowing necessary changes in state law. The 1980 Reconciliation Act already requires that the work test be applied to all extended benefits recipients after April 1, 1981. These modifications would save $523 million in FY 1981 and $1.2 billion in FY 1982.

Abolishing the national trigger would reduce costly unemployment insurance benefits in states that would otherwise not qualify for extended benefits. In addition, efficiency in the labor market would be enhanced by eliminating one of the sources creating work disincentives. When the national trigger is "on," benefits are extended in all states, even those with relatively low unemployment rates. Despite the considerably better job opportunities in such states, unemployment may rise as a result of increased work disincentives associated with the availability of more benefits.

The proposal would also exclude extended benefits recipients from the calculation of the IUR. The problem with using the IUR as a measure of unemployment for triggering purposes is that it creates an extended benefits program which becomes self-perpetuating. When the trigger is "on," all persons filing claims for benefits are included in the IUR. This results in exhaustees that normally would no longer be considered part of the labor force to be included in the IUR for an additional 13 weeks. On the other hand, when the trigger is "off," those same workers are excluded. Making this fundamental change would save substantial benefit payments in states that have already reached their triggering level. An even better approach, however, would be to use the overall unemployment rate in calculating the trigger because it would more accurately reflect job availability in the economy.

Raising the state trigger level is desirable because it would ensure that only those in genuine need receive assistance.

This, in part, is necessary to compensate for the changing composition of the labor force, which over the years has raised the natural rate of unemployment. Finally, strengthening the work test can eliminate much of the waste and fraud in the program.

Although the changes proposed are all desirable from an efficiency and equity standpoint, they do not go far enough. The extended benefits program should be eliminated entirely. The original purpose of unemployment compensation was to provide temporary relief. The program is not suited to correct long-term structural problems.

TRADE ADJUSTMENT ASSISTANCE

Trade Adjustment Assistance (TAA) was introduced in 1962 to assist workers suffering from increased imports, which were a direct result of government policies aimed at the liberalization of international trade. Today, however, the Secretary of Labor can declare workers eligible if imports have contributed significantly to unemployment and to a decline in the sales and/or production of the firm(s) in question. In other words, workers no longer have to prove that they are hurt by freer trade or that imports are the major cause of their injury. The primary purpose of the TAA program is to help workers adjust to changed economic conditions by easing the transition period between jobs. Assistance available to workers consists of: 1) trade readjustment allowances; 2) employment services; and/or 3) job search and relocation allowances. TAA benefits supplement unemployment insurance benefits by providing 70 percent of a worker's former average weekly wage, up to a maximum of the national average weekly manufacturing wage. Because unemployment insurance replaces only about 50 percent of gross earnings, TAA can be significant to the unemployed worker. In addition, these benefits are available for up to a year. In FY 1980, outlays on the program had grown to 1.7 billion dollars, which was more than six times as much as in the preceding year.

The major problem with TAA is that it compounds all the problems associated with unemployment compensation. The more generous benefits and the lengthier entitlement period exacerbate work disincentives. Greater benefits also discourage workers from seeking employment in more stable industries. Since employers pay no supplemental tax for laying off workers who would receive TAA benefits, an employer may find it profitable to lay off workers during a period of slack demand, assuming that relatively generous TAA benefits will induce a worker to wait to be rehired rather than actively search for a new job. Finally, TAA creates inequities by discriminating in favor of a select group of unemployed workers, those affected by imports.

The Administration proposes to extend TAA benefits only to those workers who have exhausted their regular unemployment compensation and to limit the size of these benefits to levels no higher than those under unemployment insurance. An unemployed worker will be allowed to receive benefits from TAA and unemployment insurance for up to a year. These changes will become effective October 1, 1981, and could reduce spending by $1.15 billion in FY 1982 alone.

The limitations proposed on the availability of TAA benefits would improve efficiency within the program markedly. The results of several studies seem to indicate that reducing the availability of benefits would dramatically mitigate pernicious practices of employees and employers alike. One such study found that TAA recipients were much more likely to have experienced temporary unemployment than their counterparts receiving only unemployment insurance. Moreover, they were much less likely to have changed their industry or occupation. It can be said that "one of the surest ways to bring about adjustment is to provide no assistance, and assistance that compensated for every burden would leave no incentive to adjust."[1] The generous assistance payments seem to act as a deterrent to workers from seeking employment in new areas, thereby artificially generating too strong an attachment to a vulnerable industry. The proposed changes are needed to restore work incentives and to discourage misuse of the program.

Although the proposed changes in TAA would result in great savings and lead to a more efficient allocation of resources, the program would still have some shortcomings. Even greater savings could be realized if the eligibility requirements were made more stringent by requiring workers not only to show that they were displaced as a direct result of U.S. international trade liberalization but that it had been the single most important cause of their injury. To further this goal, the role of determining eligibility should be returned to the International Trade Commission. The Department of Labor has all too often demonstrated a bias in favor of organized labor, many of whose members are TAA recipients. This is important because there often is only a very tenuous link between layoffs and increased unemployment from imports. Is greater compensation then justifiable for workers who are laid off because their firms failed to modernize or because workers have demanded excessive compensation and, consequently, have effectively priced themselves out of the market? Automobile workers, for example, currently receive a large amount of supplemental benefits despite the ruling by the ITC that imports were not a substantial cause or threat of serious injury to the U.S. auto industry. Instead, the Commission found that the recession, rising costs of credit, high gasoline prices, and the resulting shift in demand for small cars harmed the industry more than imports. Moreover, since workers produce goods and services for local, regional, national, and international markets,

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[1] J. D. Richardson, "Trade Adjustment Assistance Under the U.S. Trade Act of 1974: An Analytical Examination and Worker Survey," National Bureau of Economic Research, Working Paper 556, September 1980.

and all of these workers may be affected by unfavorable conditions, why should import-affected workers receive preferential treatment solely because they happen to produce for an international market? This would be especially true if increased imports were a result of greater competition rather than trade concessions granted by the government. Import-affected workers, however, are sometimes considered more deserving because their layoff is the result of promoting a socially desirable policy, i.e., one meant to achieve the greater benefits associated with free trade. Although this may be true, workers in other industries often are displaced for equally deserving causes. For example, stricter environmental controls, more stringent safety standards, and deregulation are just a few. Yet workers who become unemployed as a result of these policies receive no supplements beyond unemployment compensation.

Finally, the availability of TAA after 26 weeks of unemployment compensation renders it more like an extended benefits program. These payments should be reduced drastically, while expanding the availability of the adjustment services.

SPENDING CUTS

The tax proposal, unemployment insurance, and trade adjustment assistance programs are designed to increase incentives to work and invest. To free the resources for the private sector expansion, the Administration proposes $41.4 billion in on-budget spending reductions, another $5.7 billion in off-budget cuts, and $2.0 billion in users charges. While these cuts are significant, staggering to some, there is considerable potential for even greater reductions. Following the Administration's breakdown, the remainder of this paper will examine the President's proposal and suggest some additional reductions.

Revise Entitlements to Eliminate Unintended Benefits

The major cuts within this section are reform of the food stamp program (expected to save $1.8 billion in FY 1982), elimination of both the social security minimum payment ($1.0 billion) and the adult student payment ($700 million), and the establishment of a cap on federal Medicaid payments to the states ($1 billion). The Administration also proposes to limit cost of living adjustments for the civil service retirement system to once a year ($510 million).

Some additional changes not recommended by Reagan which could provide substantial savings include limiting veterans' compensation payments to veterans and survivors whose disabilities are traceable either to combat or job-performance, eliminating all pensions for veterans and survivors which are not "service-connected" and dismantling the VA health care system.[2] Many of

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[2] See Cotton M. Lindsay, "Veterans' Benefits and Services," in Eugene J. McAllister, ed., Agenda for Progress: Examining Federal Spending (Washington, D.C.: The Heritage Foundation, 1981), p. 286.

those currently receiving such assistance would fall back on the less remunerative Medicaid system but, despite that shift, the changes outlined above could save $8 billion in FY 1982.

Reduce Middle-Upper Income Benefits

The February 18 budget also outlines cuts of $1.6 billion through the child nutrition program and $800 million restructuring the Guaranteed Student Loan and the Pell grant programs. In addition, the Student Loan Marketing Association (Sallie Mae) would no longer have access to the Federal Financing Bank. The latter would reduce federal credit demands and promote approximately $15 billion of off-budget savings over the next five years. These three changes are directed at benefits received by the middle and upper income levels.

Some additional policy changes which would reduce the benefits received by the non-needy include introducing cost sharing in the Medicare program and lowering the payment limitation for agricultural deficiency payments from $50,000 to $10,000.

Recover Clearly Allocable Costs from Users

To achieve $2.0 billion in FY 1982 receipts the Administration proposes to charge inland waterway, airport and Coast Guard users fees through increases in barge fuel taxes, aviation fuel taxes, and boat and yacht owner fees respectively. Another fee which would not only relieve the federal government of fiscal responsibility but, also promotes greater economic efficiency would be to incorporate effluent taxes in the 97th Congress' reauthorization of the Clean Air and Water Acts.

Apply Sound Criteria to Economic Subsidy Programs

The Administration also anticipates FY 1982 savings of $10.3 billion from changes in subsidy programs. These include reductions in dairy price supports and Farmers Home Administration lending, elimination of the Economic Development Administration, restructuring the synthetic fuels program and cutting back alternative energy supply programs. Further reductions are proposed in the Amtrak, Postal Service, and mass transit operating subsidies and Export-Import Bank direct lending. The largest savings will result from the phase-out of Titles II-D and VI of CETA ($3.6 billion in FY 1982).

There are two criticisms of the cuts in subsidies. First, in most instances the entire subsidy should be eliminated. Secondly, there were several programs which could have been included. In the cut list the Overseas Private Investment Corporation, agricultural deficiency payments, and U.S. flagship subsidies are all excellent candidates for elimination.

Another possibility would be to terminate the Strategic Petroleum Reserve. The immediate decontrol of oil prices has created the necessary incentive for the private sector to stockpile reserves. Because there are a number of oil companies, or even entrepreneurs, it is very likely that their summed expectations regarding a future embargo and its severity, will be more accurate than the government's. Thus, the stockpile will be more efficiently maintained by the private sector.

Stretch Out and Retarget Public Sector Capital Improvement Programs

The critical elements of this section are an 11 percent reduction in planned water resources projects, deferring municipal water treatment grants, cutting urban mass transit grants, and slowing down highway construction grants.

The criticism is not with what is cut but rather with what remains. Sewage treatment plants, mass transit grants, and even water resource projects are local and regional responsibilities. Rather than defer or stretch out these programs, an orderly termination should be enacted.

Improve Fiscal Restraint on Other Programs of National Interest

The $3.2 billion in FY 1982 savings contained in this section is derived from a large number of relatively small cuts. Some of the more prominent include impact aid, vocational education, NASA, and foreign aid programs, such as PL 480 and multilateral development banks.

The programs contained within this heading offer a unique opportunity for experiments designed to increase both private sector contributions and more desirable outcomes. For instance, in scientific research the federal government could promote private involvement by changing the rules of appropriability, encouraging research associations, engaging in international cost sharing, and even offering a retroactive prize program.[3] A greater reliance on market mechanisms could considerably enhance the efficiency of such programs while permitting reductions in federal spending.

Consolidate Categorical Grant Programs into Block Grants

To reduce administrative expenses and promote greater state discretion, the Reagan Administration proposes to consolidate 45 education programs into two block grants, one to the state, the other to the local education agencies. It is also proposed that 40 federal health and social services programs be consolidated into one or more block grants to the states.

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3 See Richard Speier, "General Science, Space, and Technology," in McAllister, op. cit., p. 63.

Reduced Overhead and Personnel Cuts

To attain greater personnel and management efficiency, the Administration has proposed a number of cost savings measures. In defense, these include the increased use of contracting services, multi-year procurement, and annual cost of living adjustments for federal retirees. Also expected to offer substantial savings are the ceiling on federal civilian employment, and overhaul of the federal pay comparability standard.

Another defense efficiency measure would be to increase the term of first enlistment and curtail re-enlistments.[4] By reducing accessions, the training costs could be reduced. In addition, less retention of first-term enlistees would reduce the retirement liability.

CONCLUSION

The Reagan program embodies the changes in economic perspective, tax policy, and federal spending necessary to bring about a more efficient and productive economy. There are two caveats, however. The first is that regardless of how Congress alters the plan or how it fares in the short run, the Administration should continue to pursue the current course. The reason is not only that the program is sound, but that consistency is essential to altering expectations.

The second warning is that should Congress fear the tax cut to be too large, it should cut spending even more deeply than the Reagan proposals, rather than drastically alter the tax proposal. It is critical that the marginal tax rate cuts and the accelerated depreciation schedule remain intact.

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[4] See William Schneider, Jr., "Defense," in McAllister, op. cit., p. 1.