
PART 1

THE BUDGET MESSAGE

OF THE

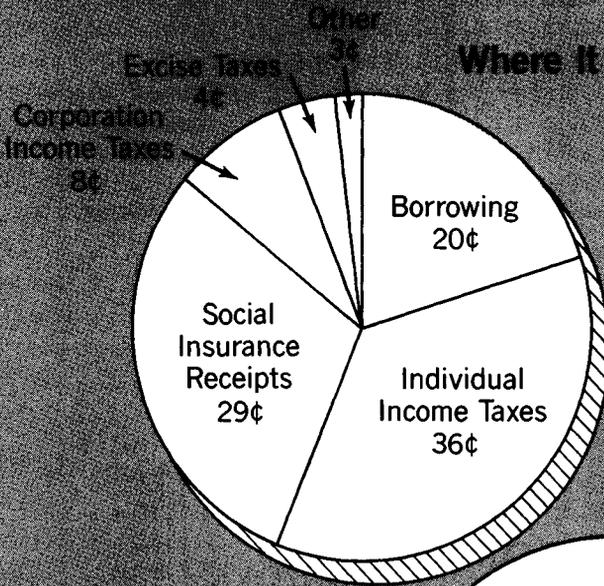
PRESIDENT

M1

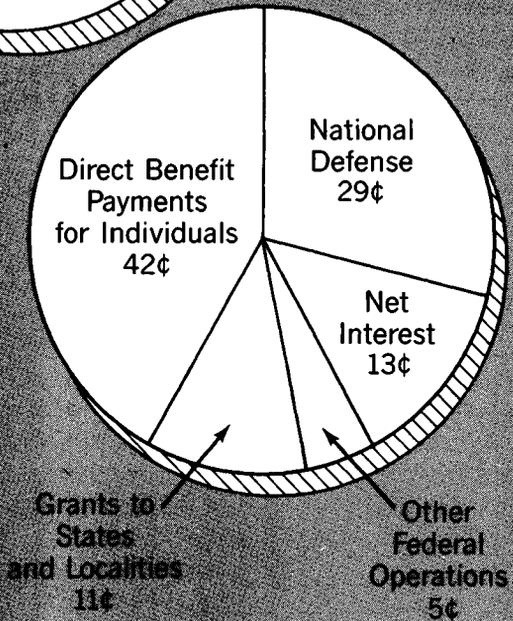
The Budget Dollar

Fiscal Year 1985 Estimate

Where It Comes From



Where It Goes



BUDGET MESSAGE OF THE PRESIDENT

To the Congress of the United States:

In the past year, the Nation's prospects have brightened considerably. The economy has grown strongly—beyond expectation. Inflation has been reduced to its lowest rate in 16 years. Unemployment has declined faster than at any other time in 30 years. We are well on our way to sustained long-term prosperity without runaway inflation.

Our national security is being restored. Our domestic programs are being streamlined to reflect more accurately the proper scope of Government responsibility and intervention in our lives. Government operations are being made more effective and efficient, as steps are taken to reduce costs.

These developments are the result of the program I proposed 3 years ago to correct the severe economic and political problems caused by previous short-sighted and misguided policies and priorities. That program focused on long-range real growth. My tax proposals were designed to provide badly needed incentives for saving and productive investment. I supported the Federal Reserve in its pursuit of sound monetary policy. I worked with the Congress to reverse the growth of Government programs that had become too large or had outlived their usefulness, and as a result, domestic programs, which had been growing rapidly for 3 decades, have finally been contained. I worked to eliminate or simplify unnecessary or burdensome regulations.

To the Nation's great good fortune, the preceding Congress appreciated the fundamental soundness of this program and joined with my administration in helping to make it a reality. Frequently, because of entrenched constituency special interests, the political risks involved in doing so were great. I thanked Members then, and continue to be grateful, for the crucial support my program received. The Nation is now beginning to reap the solid fruits of our joint perseverance and foresight.

The economy's response has fully vindicated my economic program. During the past 2 years the percentage rise in consumer price index has been no more than it was during the first 6 months of 1980. Economic recovery has been vigorous during the past year, with real GNP rising over 6% and industrial production by 16%. Unemployment, though still unacceptably high, has declined by a record 2½ percentage points in a single year. Capacity utilization

in American plants has risen dramatically. Business investment in new plant and equipment has risen 11½% in the past year, in real terms. American productivity, stagnant from 1977 to 1981, climbed 3.7% between the third quarter of 1982 and the third quarter of 1983. Interest rates declined substantially in mid-1982, followed by a major, sustained rally of the stock market that added half a trillion dollars to the net financial worth of American households. Real disposable personal income rose 5.1% in 1983. After a substantial decline, the U.S. dollar has rallied powerfully to its highest level in more than a decade.

We are not, however, out of the woods yet. Despite our success in reducing the rate of growth of nondefense spending in the last three budgets, spending in 1985 will exceed 1981 levels by 41%, reflecting continued increases in basic entitlement programs, essential increases in defense spending, and rapid growth of interest costs. Clearly, much remains to be done. The task of rebuilding our military forces to adequate levels must be carried to completion, and our commitment to provide economic and military support to small, poor nations that are struggling to preserve democracy must be honored. At the same time, further action is required to curb the size and growth of many programs and to achieve managerial efficiencies throughout Government, wherever the opportunity is present.

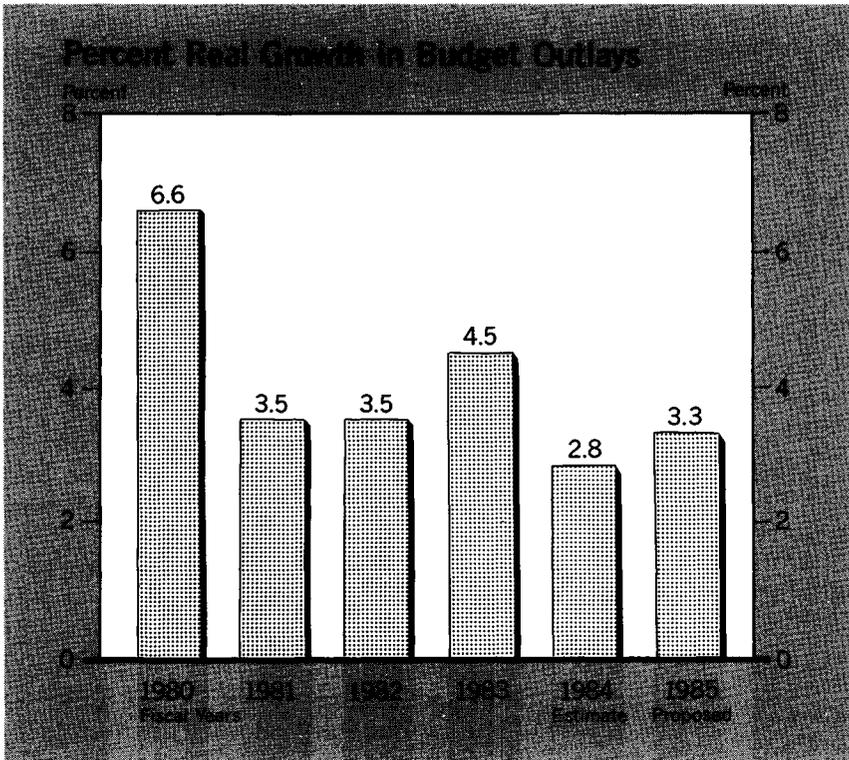
THREE YEARS OF ACCOMPLISHMENT

Last year, I reviewed the dramatic improvements during the preceding 2 years in Government operations, and in the way they affect the economy. I am happy to report that these improvements continued through a third year.

- Where the growth rate of spending was almost out of control at 17.4% a year in 1980, it will decline to 7.3% this year.
- Where spending grew 64% over the 4 years from 1977 to 1981, it will rise by only 41% over the 4-year period from 1981 to 1985, despite legislated cost-of-living adjustments and the needed defense buildup.
- The Federal tax system has been significantly restructured. Marginal income tax rates have been substantially reduced, greatly improving the climate for saving and investment. Depreciation reform has been enacted, restoring the value of depreciation allowances eroded by inflation. Tax loopholes have been closed, making the tax structure more equitable. Efforts have been made to shift to financing Government programs through user fees commensurate with benefits and services provided.
- Our military strength is being restored to more adequate levels.

- Domestic spending, which grew nearly 3-fold in real terms in a little more than 2 decades, will actually be lower this year than it was in 1981.
- The rapid growth of means-tested entitlement programs has been curbed. Eligibility criteria have been tightened to target benefits more to the truly needy, and significant steps have been taken to improve the efficiency and effectiveness of these programs. Unnecessarily frequent cost-of-living adjustments were pared back.
- The social security system has been rescued from the threat of insolvency raised by rampant inflation, excessive liberalizations, and lagging growth of its tax base.
- Unnecessary or excessive Federal credit activities have been eliminated or cut back. Improvements in the management and control of Federal credit activities are being pursued. The administration has supported the basic intent of proposed legislation that would move off-budget lending onto the unified budget, in order to provide better budgetary control over Federal lending.
- Proliferation of regulations and red tape has been stopped. The number of new Federal rules has fallen by over a quarter during the past three years, and hundreds of unnecessary old rules have been eliminated. For the first time, the *Federal Register* of new regulatory actions has grown shorter for three consecutive years; it is now one-third shorter than in 1980. Federal paperwork requirements have been cut by well over 300 million hours annually, and will be reduced even further in 1984. This has saved the American public over 150,000 work-years that had been spent every year filling out unnecessary Federal forms and reports. Our regulatory reform efforts to date will save individual citizens, businesses, and State and local governments over \$150 billion over the next decade.
- Major management improvement initiatives are underway that will fundamentally change the way the Federal Government operates. The President's Council on Integrity and Efficiency has reported \$31 billion in cost reductions or funds put to better use.
- The Federal nondefense work force has been reduced by 71,000 employees since I took office.

These are impressive accomplishments—accomplishments to be proud of and to build on. And together we can build on them. With this budget I call on all Members of the Congress once again for additional steps to ensure the firmness of our foundations and overcome the Nation's budget problem.



MAINTAINING ECONOMIC RECOVERY

Before us stands the prospect of an extended era of peace, prosperity, growth, and a rising standard of living for all Americans. What must we do to ensure that that promise shall be realized and enjoyed in the years to come? What must we do to ensure that the high price of adjustment to this new era paid by the Nation in recent years shall not have been paid in vain?

All signs point to continued strong economic growth, vigorous investment, and rising productivity, without renewed inflation—all but one. Only the threat of indefinitely prolonged high budget deficits threatens the continuation of sustained noninflationary growth and prosperity. It raises the specter of sharply higher interest rates, choked-off investment, renewed recession, and rising unemployment.

This specter must be laid to rest: just as fears of rampant inflation and its attendant evils are being laid to rest; just as fears of helplessness before growth in Soviet military might and all it threatens are being laid to rest; just as fears that the Nation's

social security system would "go under" have been laid to rest. A number of actions will be required to lay it to rest. This budget requests these actions of Congress; it calls for measures to continue to curb the upward momentum of Federal spending and to increase Federal receipts. Other actions involve such fundamental reform of our fiscal procedures that they will require that the Constitution be amended.

Congress has each year enacted a portion of my budget proposals, while ignoring others for the time being. It is moving slowly, year by year, toward the full needed set of budget adjustments. I urge the Congress to enact this year not only the proposals contained in this budget, but also constitutional amendments providing for a line-item veto and for a balanced budget—rather than the fitful policy of enacting a half-hearted reform this year, another one next year, and so on.

Where Congress lacks the will to enforce upon itself the strict fiscal diet that is now necessary, it needs the help of the Executive Branch. We need a constitutional amendment granting the President power to veto individual items in appropriations bills. Forty-three of the fifty States give this authority to their governors. Congress has approved a line item veto for the District of Columbia, Puerto Rico, and the trust territories. It is now time for Congress to grant this same authority to the President. As Governor of California, I was able to use the line-item veto as a powerful tool against wasteful government spending. It works, and works well, in State government. Every number in this document bears testimony to the urgent need for the Federal Government to adopt this fundamental fiscal reform.

Let us also heed the people and finally support a constitutional amendment mandating balanced Federal budgets and spending limits. I encourage our citizens to keep working for this at the grassroots. If you want to make it happen, it will happen.

We must seek a bipartisan basis for fundamental reforms of Government spending programs. We need to reexamine just what, how, and how much the Federal Government should be doing—given our need for security and well-being and our desire to leave power and resources with the people. The President's Private Sector Survey on Cost Control (Grace Commission) has already come up with some interesting suggestions in this regard that, with the help of the Congress, will be adopted wherever possible.

To those who say we must raise taxes, I say wait. Tax increases pile unfair burdens on the people, hurt capital formation, and destroy incentives for growth. Tax cuts helped sustain the recovery, leading to faster growth and more jobs. Rather than risk sabotaging our future, let us go forward with an historic reform for fair-

ness, simplicity, and growth. It is time to simplify the entire tax code so everyone is on equal footing.

The tax system must be made simpler and fairer; honest people should not pay for cheaters; the underground economy should come back into the sunlight; and everyone's tax rates should be reduced to spark more savings, investment, and incentives for work and economic growth. This is the blueprint for a brighter future and a fairer tax system. Therefore, I am directing the Department of the Treasury to complete a study with recommendations by the end of the year.

With these changes completed and the necessary fiscal tools in place, I am confident that we can devise a sweeping set of fiscal policy changes designed to reduce substantially the persistent Federal deficits that cloud our otherwise bright economic future. The plan must be based on these cardinal principles:

- It must be bipartisan. Overcoming the deficits and putting the Government's house in order will require everyone's best efforts.
- It must be fair. Just as all Americans will share in the benefits that are coming from recovery, all should share fairly in the burden of transition to a more limited role of Government in our society.
- It must be prudent. The strength of our national defense must be restored so that we can pursue prosperity in peace and freedom, while maintaining our commitment to the truly needy.
- Finally, it must be realistic. Government spending will not be curbed by wishful thinking.

In the meantime, the proposals in this budget provide important additional steps toward reducing the deficit.

MEETING FEDERAL RESPONSIBILITIES

My administration seeks to limit the size, intrusiveness, and cost of Federal activities as much as possible and to achieve the needed increase in our defense capabilities in the most cost-effective manner possible. This does not mean that appropriate Federal responsibilities are being abandoned, neglected, or inadequately supported. Instead, ways are being found to streamline Federal activity, to limit it to those areas and responsibilities that are truly Federal in nature; to ensure that these appropriate Federal responsibilities are performed in the most cost-effective and efficient manner; and to aid State and local governments in carrying out their appropriate public responsibilities in a similarly cost-effective manner. The Nation must ask for no more publicly-provided services and benefits than the taxpayers can reasonably be asked to finance.

Education.—I have devoted considerable time this year to the problems of our schools. The record of the last two decades is not good, though relieved in places by the efforts of many dedicated teachers, administrators, parents, and students. It has been extremely gratifying to observe the response all across the country to my call for a renewed commitment to educational excellence. Excellence in education will only happen when the States and school districts, parents and teachers, and our children devote themselves to the hard work necessary to achieve it. Federal money cannot buy educational excellence. It has not in the past and will not in the future. What we will do in this budget is seek resources to help the States plan and carry out education reforms. My budget includes \$729 million, about 50% more than Congress appropriated for 1984, for the education block grant and discretionary fund. States and localities will receive this increase in resources and be able to use the funds for education reform without Federal prescription and interference.

The budget also provides for stabilizing funding for almost all major education State grant programs at the 1984 level and in the future allows room for modest growth for most of these programs.

Finally, the budget reflects continued support of several more important initiatives that will strengthen American education:

- Enactment of tuition tax credits for parents who send their children to qualified private or religiously-affiliated schools.
- Establishment of education savings accounts to give middle- and lower-income families an incentive to save for their children's college education and, at the same time, to encourage a real increase in saving for economic growth.
- Reorientation of student aid programs to ensure that students and families meet their responsibilities for financing higher education.
- Permission for States or localities, if they so choose, to use their compensatory education funds to establish voucher programs to broaden family choice of effective schooling methods for educationally disadvantaged children.
- Assistance to States to train more mathematics and science teachers.

Training and employment.—While the economic forecast predicts continuing improvement in the economy and further steady declines in the unemployment rate, I recognize that there are those who lack the skills to find and hold steady jobs. This is particularly true for some of our youth. In the past, Federal training and employment programs have not always helped these people gain the skills needed for success in the job market. Instead the Government spent precious tax dollars funding temporary, dead-end, make-work jobs that did little, if anything, to prepare these people

for holding real jobs in the private sector. My administration worked with the Congress to change that. The Job Training Partnership Act, which I signed into law in 1982, involves private industry in the design and delivery of job training programs. Each year it will train 1.5 million disadvantaged adults and youths, dislocated workers, and welfare recipients in skills needed for private sector jobs. Additional work experience for over 700,000 disadvantaged youths will be provided during the summer months. What is needed now is not more Government programs, but removal of Government-created barriers that make it difficult for youths who want to work to find jobs. It has long been acknowledged that the minimum wage is a barrier to job finding for youths, especially minority youths, who lack skills. Therefore, I am again asking the Congress to authorize a wage of 75% of the minimum wage for youths newly hired for jobs during the summer months. This will let employers lower their costs to levels more in line with the skills youths possess, and it will help many young people find jobs and gain valuable work experience. The legislation I have proposed includes protections for adult workers.

Research.—Recognizing the Federal responsibility to maintain and strengthen U.S. leadership in science and technology, the budget proposes further increases of more than 10% in Government-wide funding for basic research. The \$8 billion planned for support of such research represents a relatively small share of the budget, but it is a critical investment in the Nation's future. Basic research lays the foundation for a strong defense in the years to come and for new technologies and industries that will maintain U.S. industrial leadership, create new jobs, and improve our quality of life.

Space.—Our civilian space program has made remarkable progress in the past year. The space shuttle, the world's most advanced space transportation system, has made eight pathbreaking trips into space and is progressing rapidly towards achieving routine operational status.

We can now look forward confidently to the next major challenge in space—a space station. The space station, to be placed in permanent Earth orbit in the early 1990's, is intended to enhance the Nation's science and application programs, to help develop advanced technologies potentially useful to the economy, and to encourage greater commercial use of space. The budget provides planning money to initiate this program.

National defense.—During the past 3 years, we have also taken decisive measures to increase our military strength to levels necessary to protect our Nation and our friends and allies around the

world. At the same time, we have vigorously pursued diplomatic approaches, such as arms reduction talks, in an effort to ensure the principles of security and freedom for all.

The improvement in our defense posture has been across the board. Long-overdue modernization of our strategic forces is proceeding, while our conventional forces are also being modernized and strengthened. Successful recruiting and retention over the past 3 years have resulted in all of our armed services being more fully manned with capable, high-caliber men and women.

Energy.—My administration has significantly reoriented the country's approach to energy matters toward reliance on market forces—instead of Government regulation and massive, indiscriminate Federal spending. This has resulted in greater energy production, more efficient use of energy, and more favorable energy prices. For example:

- The U.S. economy currently is using 30% less oil and gas per dollar's worth of output than it did 10 years ago when energy prices began to rise.
- Heating oil prices have been lower this past year than they were in January 1981, when I removed oil price controls. Gasoline prices have fallen to levels which, after adjustments for general inflation and sales taxes, are within 5% of those that prevailed in the U.S. in the 1950's.

Energy programs proposed in the budget are designed to complement market forces by focusing resources on limited but appropriate responsibilities of the Federal Government and by managing these programs well. Thus, for example, the budget proposes increased spending for basic and other long-term energy research. In addition, the administration continues its commitment to filling the strategic petroleum reserve. The reserve has more than tripled in size in the last three years.

Health care.—Progress has been made in slowing the explosive growth of health costs. As part of the Social Security Amendments of 1983, Congress enacted the Administration's proposed fixed price prospective payment system for hospital care. This replaced the previous Medicare hospital reimbursement system under which hospitals were reimbursed for their costs. The new prospective payment system has altered incentives and should lessen the rate of increase in hospital costs.

Under the proposals in this budget, physicians will be asked to maintain present fee levels for Medicare through the next fiscal year. Tax incentives prompting overly-costly employee health insurance benefits would be revised to make users and providers more sensitive to costs. Finally, resources for biomedical research will increase.

Transportation.—My administration has sought to shift much of the costs of transportation from the general taxpayer to those who use transportation services and facilities. I signed into law several administration-backed proposals to increase excise taxes on aviation and highway users and thereby provide funding needed to revitalize and modernize these important segments of the Nation's transportation system. The proportion of the Department of Transportation's budget financed by user fees has risen from 49% in 1982 to 72% in 1985. The budget reflects the administration's continued commitment to the "users pay" principle by including receipts proposals for nautical and aviation aids, the inland waterway system, and construction and maintenance of deep-draft ports.

Recognizing the importance of safety in our transportation systems, the budget provides for significant improvements in this area. In addition, my administration secured passage of legislation designed to rebuild the Nation's highway and public transportation facilities. This legislation substantially increased funds available to the States and local communities to complete and repair the aging interstate highway system, to rehabilitate principal rural and urban highways and bridges, and to improve mass transit systems. The budget also provides for improvements in the safety of our transportation systems.

Improved ports and channels will help to make U.S. coal exports competitive in world markets. My administration will work with the Congress to provide for timely and efficient port construction. A system that recovers a significant portion of the cost of existing port maintenance and new port construction must be enacted prior to any new construction. In the last 3 years, my administration has sent several reasonable proposals to the Congress, and progress is being made. It is time for action on this important issue.

Reducing the Federal presence in commercial transportation, currently regulated by the Interstate Commerce Commission, the Civil Aeronautics Board, and the Federal Maritime Commission, will improve the efficiency of the industry. Authority for the Civil Aeronautics Board will expire next year, and its residual functions will be assumed by other agencies. The administration will continue to seek legislation to deregulate ocean shipping, and will propose legislation to deregulate oil pipelines and natural gas. Experience since the adoption of initial transportation deregulation legislation has shown clearly that both consumers and industry benefit from reduced Federal involvement in these activities.

Criminal justice.—My administration has continued to strengthen the Federal criminal justice system by seeking major legislative changes in immigration policy, sentencing, and bail procedures, and by seeking increased funding for law enforcement activities. An additional organized crime drug enforcement task force will be

established in Florida, bringing the total number of task forces to 13. The budget proposes to bolster immigration control by strengthening border enforcement and improving the effectiveness of border inspection programs. Additional attorneys will be sought for the Internal Revenue Service and the Justice Department, underscoring my administration's determination to tackle the serious problem of tax protesters and evaders. The administration will enhance its efforts to identify, neutralize, and defeat foreign agents who pose a threat to the Nation.

International affairs.—Our foreign policy is oriented toward maintaining peace through military strength and diplomatic negotiation; promoting market-oriented solutions to international economic problems; telling the story abroad of America's democratic, free-enterprise way of life; and reducing barriers to free trade both here and abroad.

- The security assistance portion of the international affairs program has been increased to assist friendly governments facing threats from the Soviet Union, its surrogates, and from other radical regimes.
- Development aid emphasizes encouraging the private sectors of developing nations and increasing U.S. private sector involvement in foreign assistance.
- The budget provides for continuing the major expansion of international broadcasting activities started last year. Television, exchanges of people, and other programs to improve communications with foreign countries are included.
- My administration will continue to work with the Congress to strengthen the management and coordination of the Government's international trade functions by consolidating them in a Department of International Trade and Industry.

The United States faces threats to its interests in many parts of the world. The Middle East, with its vital energy resources, is still in turmoil. In Central America, Marxist forces continue to threaten democratic governments, exploiting temporary economic dislocations and the continuing poverty of less developed countries. In Africa, the poorest nations of the world are facing the prospect of great privation, accentuated by drought. This budget addresses each of these concerns:

- It continues military and economic support for Israel and Egypt, with improved financial terms.
- It provides for a significant increase in assistance to Central America, the specific nature of which will be defined after our review of the recommendations of the National Bipartisan Commission on Central America.
- It provides special humanitarian aid to counter the immediate effects of African drought and proposes a longer-term

program aimed at the root causes of Africa's economic problems.

Although now less than 2% of the budget, international programs are critical to American world leadership and to the success of our foreign policy.

Civil service retirement.—There is growing recognition that civil service retirement has far more generous benefits and is much more costly than retirement programs in the private sector or in State and local governments. Accordingly, the administration continues its strong support of the civil service reform proposals advanced in last year's budget. In 1985, the administration will focus its legislative effort on three of those proposals, in modified form: cost-of-living adjustment (COLA) reform, a high 5-year salary average for the benefit formula, and increased employee and agency retirement contributions.

GI bill rate increase.—The budget proposes legislation to provide a 15% increase in the rates of educational assistance and special training allowances to GI bill trainees and disabled veterans receiving vocational rehabilitation assistance, effective January 1985. The increase will offset increased costs since GI bill benefits were last raised in 1981. It will provide an increase in monthly education benefit checks to 544,000 veterans and their dependents and survivors.

CONTINUING REFORM OF OUR FEDERAL SYSTEM

The overall efficiency of Government in the United States can also be improved by a more rational sorting out of governmental responsibilities among the various levels of government in our Federal system—Federal, State, and local—and by eliminating or limiting overlap and duplication.

In 1981, the Congress responded to my proposals by consolidating 57 categorical programs into nine block grants. In 1982, a block grant was created for job training in the Jobs Training Partnership Act.

The administration is improving the management of intergovernmental assistance by providing State and local elected officials with greater opportunity to express their views on proposed Federal development and assistance actions before final decisions are made. Under Executive Order 12372, Intergovernmental Review of Federal Programs, which I signed in July 1982, Federal agencies must consult with State and local elected officials early in the assistance decision process and make every effort to accommodate their views. The Order also encourages the simplification of State planning requirements imposed by Federal law, and allows for the substitu-

tion of State-developed plans for federally required State plans where statutes and regulations allow.

CONTROLLING FEDERAL CREDIT PROGRAMS

Federal credit in all its forms imposes costs on the U.S. economy that must be weighed against its benefits. Federal intervention through guarantees and direct loans may misdirect investment and preempt capital that could be used more efficiently by unsubsidized, private borrowers. Because federally assisted borrowers are frequently less productive than private borrowers, large Federal credit demands, and the degree of subsidy involved in Federal credit activity, must be reduced if we are to improve prospects for economic growth.

The administration continues its strong commitment to control Federal direct loans and loan guarantees. It has supported the basic intent of proposed legislation to move off-budget Federal lending into the unified budget. It seeks other basic reforms in the way in which direct loans and loan guarantees are presented and controlled.

In the coming year, my administration will issue a directive establishing Government-wide policies on credit. This directive will be both an explicit statement of the administration's goals in providing credit assistance and a means of controlling the manner in which that assistance is provided.

REGULATORY REFORM

Federal regulation grew explosively throughout the 1970's. Whether well or poorly designed, whether aimed at worthy or dubious objectives, these rules have one thing in common: they "tax" and "spend" billions of dollars entirely within the private sector of the economy, unconstrained by public budget or appropriations controls.

My administration has taken steps to correct this problem. Under Executive Order 12291, all Federal regulations must be reviewed by the Office of Management and Budget before being issued to determine whether their social benefits will exceed their social costs. As a result of this review process, we have reversed the rate of growth of Federal regulations. Hundreds of ill-conceived proposals have been screened out, and hundreds of existing rules have been stricken from the books because they were unnecessary or ineffective. Equally important, numerous existing regulations have been improved, and new rules have been made as cost-effective as possible within statutory limits. We are steadily winding down economic controls that regulate prices, form barriers to entry for new firms, and other anti-competitive regulations. At the same

time we are increasing the effectiveness of our programs promoting health, safety, and environmental quality.

Our regulatory reform program has been open and public. New rules and changes to existing rules now require public notice and comment. My Executive Order requires regulatory agencies to consider the interests of the general public as well as special interest groups in rulemaking proceedings. The Task Force on Regulatory Relief and the Office of Management and Budget have issued regular reports detailing the progress of regulatory reform efforts. *The Unified Agenda of Federal Regulations*, issued twice each year, describes all planned and pending regulatory changes in virtually all Federal agencies. The administration's *Regulatory Policy Guidelines*, published in August 1983, is the first comprehensive statement of regulatory policy ever to be issued.

I believe it is time the policies and procedures of Executive Order 12291 were enacted into law. Individual regulatory decisions will always be contentious and controversial, but surely we can all agree on the general need for regulatory reform. Making each Government rule as cost-effective as possible benefits everyone and strengthens the individual regulatory statutes. Regulation has become such an important role of the Federal Government that strong and balanced central oversight is becoming a necessity and a bi-partisan objective. The Laxalt-Leahy Regulatory Reform Act, which passed the Senate unanimously in 1982, would have accomplished this reform. I strongly urge the Congress to take up and pass similar legislation this year. In addition, my administration continues to support measures to deregulate financial institutions.

IMPROVING THE EFFICIENCY OF GOVERNMENT

It is important to continue to reduce the size of Government. It is equally important to use the remaining resources as efficiently and effectively as possible. My administration has begun to make great strides in doing exactly that.

During the past 3 years, we have initiated several Government-wide management improvement efforts under the guidance of the Cabinet Council on Management and Administration. They are:

- Reform 88;
- Personnel management reform;
- Federal field structure reform; and
- The President's Private Sector Survey on Cost Control.

These management improvement and cost reduction programs focus on 4 objectives:

- Reducing fraud, waste, and mismanagement;
- Improving agency operations;
- Developing streamlined Federal Government management systems; and

—Improving the delivery of services.

Reducing fraud, waste, and mismanagement.—This objective seeks better use of appropriated dollars. The President's Council on Integrity and Efficiency (PCIE) was formed in early 1981 and is made up of 18 department and agency Inspectors General. They recently reported \$8.4 billion in cost reductions or funds put to better use in the last 6 months of 1983 and a total of \$31 billion since they were appointed. The PCIE is beginning to direct its efforts toward preventing problems before they occur, through improved technology and better audit processes, as described in their latest report.

The PCIE also found that enormous waste was occurring because the Federal Government had never established an effective cash management system—despite the fact that it handles almost a trillion dollars in cash annually. This is currently being corrected by installing sophisticated, up-to-date systems that the Department of the Treasury estimates could save as much as \$3½ billion a year.

When my administration came to office we found delinquent debt owed the Government rising at a rate of over 40% per year—with a total debt outstanding of over \$240 billion. After only 2 years' effort, this annual growth rate has been reduced to 2%. A credit pre-screening system is now being put in place, and automated collection centers are being installed.

Federal procurement involves annual expenditures of \$170 billion. Procurement was an overly complex process with only 50% of our contract dollars awarded under competitive bid. My administration has replaced three sets of regulations with one, and we are now setting up a new pro-competitive policy to cut costs.

We have extended our fight to reduce waste and mismanagement to a direct attack on that nemesis that has always characterized the Federal Government: red tape and paperwork. We have already reduced the paperwork burden placed on the private sector by the Federal Government by well over 300 million hours. In this current fiscal year we intend to reduce the burden by another 130 million hours.

Further savings and improvements are possible. The President's Private Sector Survey on Cost Control (Grace Commission) developed numerous recommendations for savings and cost avoidance. These recommendations range from reducing costs of Federal employee retirement programs to upgrading the Government's seriously outdated and inefficient management and administrative systems. I have already included many of these ideas in this budget and will include more in future budgets. My administration will develop a tracking system to make sure they are carried out.

These are but a few of the efforts underway to make sure that appropriated funds go further and are used for the purposes for which they were intended.

Improving agency operations.—I am directing Federal agencies to coordinate their administrative activities so that they reduce their current operating costs immediately, rather than wait for future improvements in systems and technologies. Savings resulting from these efforts are reflected in this budget. These efforts include: (1) consolidating headquarters and regional administrative services; (2) requiring service centers to meet minimum productivity standards for processing documents; (3) using private sector contractors to provide support services where appropriate and economical; (4) reducing Federal civilian employment by 75,000 by the beginning of 1985, reducing higher graded staff, and improving personnel planning; (5) reducing office space by 10%; (6) reducing printing plants by 25% and publications by 25%; and (7) eliminating the processing of documents altogether for most small agencies, by requiring them to obtain services from larger agencies that have efficient centers.

Developing streamlined Federal Government management systems.—As we are reducing the size of Government and reducing fraud, waste, and abuse, we also need to change fundamentally the way the Federal Government is managed. When I came into office, we found that the Federal Government lacked a well-planned compatible management process, so we set about developing one. This effort involves five major projects: (1) planning and budgeting, (2) financial management and accounting, (3) personnel management and payroll, (4) personal and real property, and (5) automatic data processing and telecommunications management. Responsibilities and resources for the development of each of these management systems have been assigned to those agencies that have or are capable of developing the most advanced management system in each category. Without this effort, the Federal Government would continue to operate in an inefficient manner that does not serve our citizens well.

Improving the delivery of services.—My administration is looking seriously at the way the delivery of Federal services is handled across the country. The objective of this effort is to achieve improved service at lower cost, through improved technology and management techniques such as prescreening, computer matching, adjusted payment schedules, contractor and grantee performance incentives, and a streamlined field structure.

All of these efforts are being planned and coordinated centrally as part of the budget process. The results of these efforts will be

reported to the Congress together with resulting savings and proposals to upgrade management of the Federal Government.

CONCLUSION

Vigorous, noninflationary economic recovery is well underway. The long winter of transition from the misguided policies of the past, with their inflationary and growth-deadening side-effects, is now yielding to a new springtime of hope for America. The hope of continued recovery to long-term noninflationary prosperity can be realized if we are able to work together on further deficit reduction measures. Bold, vigorous fiscal policy action to break the momentum of entrenched spending programs, together with responsible and restrained monetary policy, is essential to keep the recovery on track; essential to the Nation's future economic health and vitality. Limited measures to increase receipts will also be necessary to make our tax system fairer and more efficient. But it is important—more than important, *crucial*—to get the mix of spending restraint and receipts increases right. There must be substantial reductions in spending and strictly limited increases in receipts.

I call urgently upon the Congress, therefore, to take the actions proposed in this budget. Far too much is at stake to permit casual dismissal of these essential belt-tightening measures. The Nation has paid a high price for the prospect of a secure, prosperous, noninflationary future; that prospect must not be sacrificed to a sense of complacency, to an expedient ducking of the issues.

With confidence in the ultimate beneficial effects of our actions, let us seize the high ground and secure, for ourselves and our posterity, a bright and prosperous future—a future in which the glory that was America is again restored.

RONALD W. REAGAN

FEBRUARY 1, 1984

PART 1

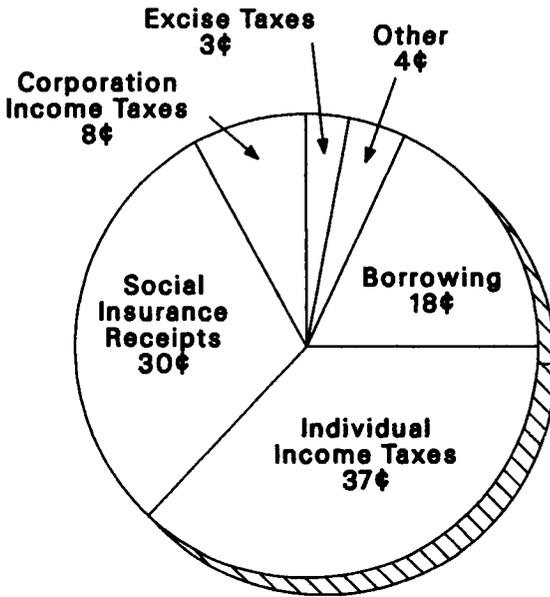
**THE BUDGET MESSAGE
OF THE
PRESIDENT**

M1

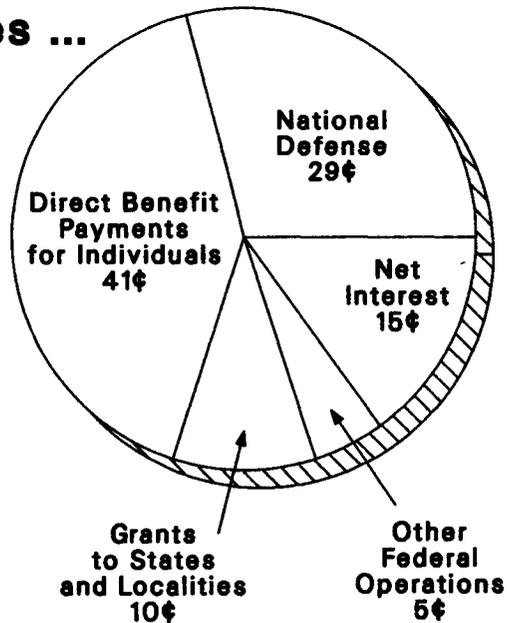
The Budget Dollar

Fiscal Year 1986 Estimate

Where It Comes From ...



Where It Goes ...



BUDGET MESSAGE OF THE PRESIDENT

To the Congress of the United States:

In the past 2 years we have experienced one of the strongest economic recoveries of the post-war period. The prospect of a substantially brighter future for America lies before us. As 1985 begins, the economy is growing robustly and shows considerable upward momentum. Favorable financial conditions presage a continuation of the expansion. Production, productivity, and employment gains have been impressive, and inflation remains well under control. I am proud of the state of our economy. Let me highlight a few points:

- The economy expanded at a 6.8% rate in 1984 and at a 6% annual rate over the 2 years since the recession trough at the end of 1982—faster than any other upturn since 1951.
- Confidence in the economy has prompted business firms to expand their capital facilities. Real investment in new plant and equipment has grown 15.4% annually since the end of 1982—faster than in any other post-war recovery.
- The ratio of real investment to real GNP has reached its highest level in the post-war period.
- Industrial production is 23% above its level at the recession trough in November 1982—a greater advance than in any other recovery since 1958.
- Corporate profits have risen nearly 90% since the recession trough in 1982—the fastest 8-quarter increase in 37 years.
- Civilian employment has grown 7.2 million over the past 25 months and the number of unemployed has fallen by 3.7 million. In the last 4 months alone, more than 1.1 million Americans have found jobs.
- Inflation remains well under control. The December 1984 CPI was 4% higher than a year earlier, about a third of the rate of inflation this administration inherited. The GNP deflator, the broadest measure of inflation, increased only 3.5% last year and at only a 2.4% annual rate in the fourth quarter.
- The prime rate of interest is now only half of what it was when I took office.

Contrast our current circumstances with the situation we faced just 4 years ago. Inflation was raging at double-digit rates. Oil prices had soared. The prime rate of interest was over 20%. The economy was stagnating. Unemployment had risen sharply and

was to rise further. America's standing in world opinion was at low ebb.

All that, mercifully, is behind us now. The tremendous turnaround in our fortunes did not just happen. In February 1981, I presented the four fundamentals of my economic program. They were:

- Reducing the growth of overall Federal spending by eliminating activities that are beyond the proper sphere of Federal Government responsibilities and by restraining the growth of spending for other activities.
- Limiting tax burdens to the minimum levels necessary to finance only essential government services, thereby strengthening incentives for saving, investment, work, productivity, and economic growth.
- Reducing the Federal regulatory burden where the Federal Government intrudes unnecessarily into our private lives, the efficient conduct of private business, or the operations of State and local governments.
- Supporting a sound and steady monetary policy, to encourage economic growth and bring inflation under control.

FOUR YEARS OF ACCOMPLISHMENT

These policies were designed to restore economic growth and stability. They succeeded.

The past 4 years have also seen the beginning of a quiet but profound revolution in the conduct of our Federal Government. We have halted what seemed at the time an inexorable set of trends toward greater and greater Government intrusiveness, more and more regulation, higher and higher taxes, more and more spending, higher and higher inflation, and weaker and weaker defense. We have halted these trends in our first 4 years.

- The rate of Federal spending growth was out of control at 17.4% a year in 1980. Under my budget proposals the growth of programmatic spending—that is, total Federal spending except for debt service—will be zero next year—frozen at this year's levels.
- Further, spending will grow only 30% over the 4 years from 1982 to 1986, compared to its record pace of 66% between 1977 and 1981, and this despite legislated additions to my program and the needed rebuilding of our defense capabilities.
- The Federal tax system was changed for the better—marginal tax rates were reduced and depreciation reform introduced. These reforms were designed to increase incentives for work, training and education, saving, business growth, and capital

- expansion. Tax loopholes have been closed, improving the equity of the system.
- Domestic spending, which previously grew faster than any other major part of the budget (nearly four-fold in real terms between 1960 and 1980), will have been virtually frozen from 1981 to 1985.
 - Our defense capabilities are now getting back to a level where we can protect our citizens, honor our commitments to our allies, and participate in the long-awaited arms control talks from a position of respected strength.
 - Federal credit programs, which had also grown out of control, have been cut back, and their management has been vastly improved.
 - The rapid growth of regulations and red tape has also been halted. The number of Federal rules published by agencies has fallen by over 35% during the past 4 years, and many unnecessary old rules have been eliminated. For the first time, the Federal Register of new regulatory actions has grown shorter for 4 consecutive years; it is now 41% shorter than it was in 1980.
 - Major management improvement initiatives are underway that will fundamentally change the way the Federal Government operates. The President's Private Sector Survey on Cost Control has completed its report, and many of its recommendations are included in this budget. The President's Council on Integrity and Efficiency has reported \$46 billion in improved use of funds through reduction of waste and fraud.
 - The Federal nondefense work force has been reduced by over 78,000.

The proposals contained in this budget will build on the accomplishments of the last 4 years and put into action a philosophy of government that is working and that has received the overwhelming endorsement of the American people.

THE 1986 BUDGET PROGRAM

If we took no action to curb the growth of spending, Federal outlays would rise to over a trillion dollars in 1986. This would result in deficits exceeding \$200 billion in each of the next 5 years. This is unacceptable. The budget I propose, therefore, will reduce spending by \$51 billion in 1986, \$83 billion in 1987, and \$105 billion in 1988. Enactment of these measures would reduce the deficit projected for 1988 to \$144 billion—still a far cry from our goal of a balanced budget, but a significant step in the right direction and a 42% reduction from the current services level projected for that year.

Last year my administration worked with Congress to come up with a downpayment on reducing the deficit. This budget commits the Government to a second installment. With comparable commitments to further reductions in the next two budgets, and, I hope, other spending reduction ideas advanced by the Congress, we can achieve our goal in an orderly fashion.

The budget proposes a 1-year freeze in total spending other than debt service. This will be achieved through a combination of freezes, reforms, terminations, cutbacks, and management improvements in individual programs. For a number of reasons, a line-by-line budget freeze is not possible or desirable. Further, such an approach would assume that all programs are of equal importance. Taken together, the specific proposals in this budget hold total Federal spending excluding debt service constant in 1986 at its 1985 level.

The budget proposals provide for substantial cost savings in the medicare program, in Federal payroll costs, in agricultural and other subsidies to business and upper-income groups, in numerous programs providing grants to State and local governments, and in credit programs. A freeze is proposed in the level of some entitlement program benefits, other than social security, means-tested programs, and programs for the disabled, that have hitherto received automatic "cost-of-living adjustments" every year. The budget proposes further reductions in defense spending below previously reduced mid-year levels.

Despite the reforms of the past 4 years, our Federal tax system remains complex and inequitable. Tax rates are still so high that they distort economic decisions, and this reduces economic growth from what it otherwise could be. I will propose, after further consultation with the Congress, further tax simplification and reform. The proposals will not be a scheme to raise taxes—only to distribute their burden more fairly and to simplify the entire system. By broadening the base, we can lower rates.

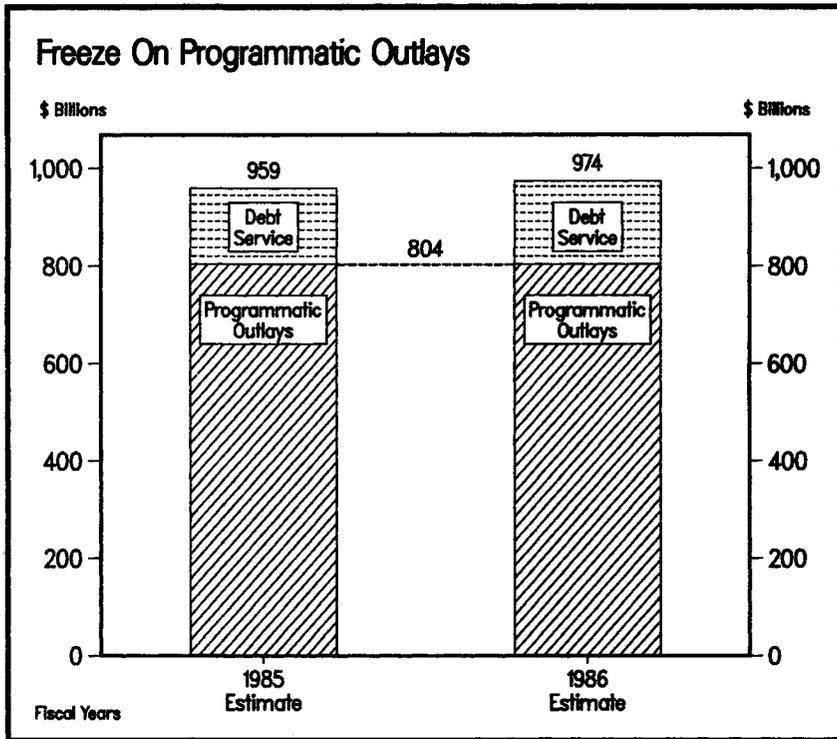
THE BUDGET TOTALS

(In billions of dollars)

	1984 actual	1985 estimate	1986 estimate	1987 estimate	1988 estimate
Receipts	666.5	736.9	793.7	861.7	950.4
Outlays	851.8	959.1	973.7	1,026.6	1,094.8
Deficit (—)	—185.3	—222.2	—180.0	—164.9	—144.4

Note: Totals include outlays that are off-budget under current law, proposed to be included on-budget.

There will be substantial political resistance to every deficit reduction measure proposed in this budget. Every dollar of current Federal spending benefits someone, and that person has a vested self-interest in seeing these benefits perpetuated and expanded.



Prior to my administration, such interests had been dominant and their expectations and demands had been met, time and time again.

At some point, however, the question must be raised: "Where is the political logrolling going to stop?" At some point, the collective demands upon the public Treasury of all the special interests combined exceed the public's ability and willingness to pay. The single most difficult word for a politician to utter is a simple, flat "No." The patience of the American people has been stretched as far as it will go. They want action; they have demanded it.

We said "no" frequently in 1981, and real spending for discretionary domestic programs dropped sharply. But we did not accomplish enough. We now have no choice but to renew our efforts with redoubled vigor. The profusion of Federal domestic spending programs must be reduced to an acceptable, appropriate, and supportable size.

It will require political courage of a high order to carry this program forward in the halls of Congress, but I believe that with good faith and goodwill on all sides, we can succeed. If we fail to reduce excessive Federal benefits to special interest groups, we will

be saddled either with larger budget deficits or with higher taxes—either of which would be of greater harm to the American economy and people.

1986 MANAGEMENT AND REGULATORY PROGRAM

Not only must both the scope and scale of Federal spending be drastically cut back to reduce the deficit: we must also institute comprehensive management improvements and administrative reforms to make sure that we use available funds as efficiently as possible.

Tough but necessary steps are being taken throughout the Federal Government to reduce the costs of management and administration. Substantial savings in overhead costs have been achieved under provisions of the Deficit Reduction Act of 1984. A 5% Federal civilian employee salary cut has been proposed; a 10% reduction in administrative overhead has been ordered; termination of programs that have outlived their usefulness is proposed; outmoded, inefficient agency field structures that have evolved over the past half-century are being consolidated and streamlined to take advantage of efficiencies made possible by modern transportation, communication, and information technology.

Administration of Federal agencies is being made more efficient through the adoption of staffing standards, automation of manual processes, consolidation of similar functions, and reduction of administrative overhead costs. A program to increase productivity by 20% by 1992 in all appropriate Government functions is being instituted, as are improved cash and credit management systems and error rate reduction programs.

This management improvement program will result in a leaner and more efficient Federal structure and will be described in a management report that I am submitting to the Congress for the first time shortly after my annual budget submission.

We have also made a great deal of progress in reducing the costs imposed on businesses and State and local governments by Federal regulations. These savings are estimated to total \$150 billion over a 10-year period. We have reduced the number of new regulations in every year of my first term and have eliminated or reduced paperwork requirements by over 300 million hours each year. In addition, the regulations are more carefully crafted to achieve the greatest protection for the least cost, and wherever possible to use market forces instead of working against them.

A recent Executive Order will strengthen the executive branch coordination that has made these accomplishments possible. For the first time, we will publish an annual program of the most significant regulatory activities, including those that precede the

publication of a proposed rule. This will give Congress and the public an earlier opportunity to understand the administration's regulatory policies and priorities.

CONCLUSION

The key elements of the program I set out 4 years ago are in place and working well. Our national security is being restored; so, I am happy to report, is our economy. Growth and investment are healthy; and inflation, interest rates, tax rates, and unemployment are down and can be reduced further. The proliferation of unnecessary regulations that stifled both economic growth and our individual freedoms has been halted. Progress has been made toward the reduction of unwarranted and excessive growth in domestic spending programs.

But we cannot rest on these accomplishments. If we are to attain a new era of sustained peace, prosperity, growth, and freedom, Federal domestic spending must be brought firmly under control. This budget presents the steps that I believe must be taken. I do not exclude other economies that Congress may devise, so long as they do not imperil my fundamental constitutional responsibilities to look after the national defense and the general welfare of the American people.

Let us get on with the job. The time for action is now.

RONALD REAGAN

FEBRUARY 4, 1985

PART 1

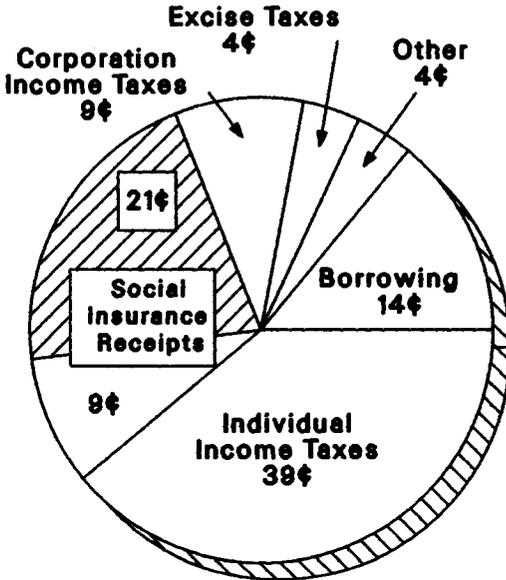
**THE BUDGET MESSAGE
OF THE
PRESIDENT**

M-1

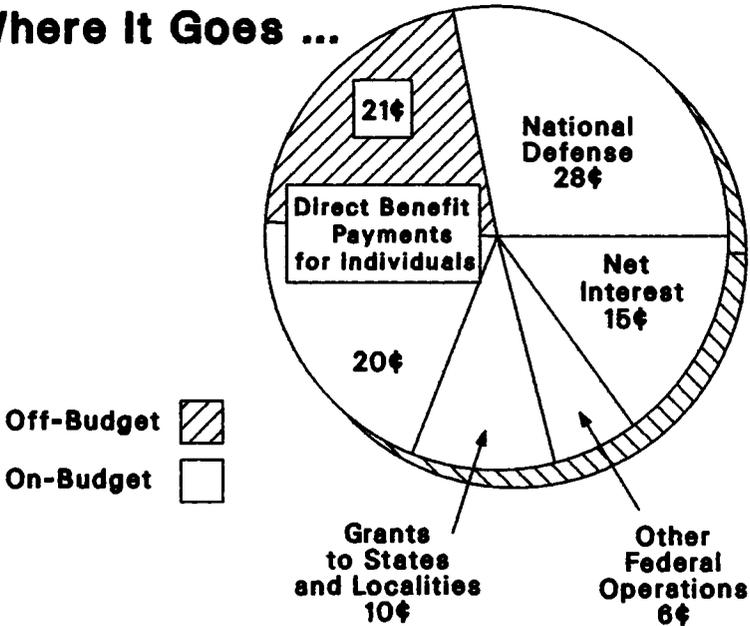
The Federal Government Dollar

Fiscal Year 1987 Estimate

Where It Comes From ...



Where It Goes ...



Off-Budget 
 On-Budget 

BUDGET MESSAGE OF THE PRESIDENT

To the Congress of the United States:

The economic expansion we are now enjoying is one of the most vigorous in 35 years. Family income is at an all-time high; production and productivity are increasing; employment gains have been extraordinary; and inflation, which raged at double-digit rates when I took office, has been reduced dramatically. Defense capabilities, which had been dangerously weakened during the 1970s, are being rebuilt, restoring an adequate level of national security and deterrence to war. Moreover, an insupportable growth in tax burdens and Federal regulations has been halted.

Let me give you a few highlights:

- Employment has grown by 9.2 million in the past three years, while the unemployment rate has fallen by 3.8 percentage points; during the three years preceding my administration, employment grew by only 5.5 million and the unemployment rate rose 0.8 percentage points.
- The highest proportion of our adult population (60%) is now at work, with more blacks and other minorities employed (14 million) than ever before.
- Inflation, which averaged 11.6% a year during the three years before I took office, has averaged only a third of that—3.8%—during the last three years.
- Real GNP has grown at a 4.5% annual rate during the past three years, compared with only a 2.2% annual rate during the last three years of the previous administration.
- The prime rate of interest and other key interest rates are less than half what they were when I took office.
- Some 11,000 new business incorporations are generated every week, and since early 1983, investment in plant and equipment has risen 44% in real terms.
- During the past three years, industrial production has risen by 25%.
- During the same period, corporate profits increased 117% and stocks nearly doubled in value.
- Federal tax revenues have returned to historic levels of approximately 18½% of GNP, as tax rates have been cut across-the-board and indexed for inflation.

- As a result of all of the above, real after-tax personal income has risen 10.6% during the last three years—an average increase of \$2,500 for each American household.

This dramatic improvement in the performance of our economy was no accident. We have put in place policies that reflect our commitment to reduce Federal Government intrusion in the private sector and have eliminated many barriers to the process of capital formation and growth. We continue to maintain a steadfast adherence to the four fundamental principles of the economic program I presented in February 1981:

- Reducing the growth of Federal spending;
- Limiting tax burdens;
- Relieving the economy of excessive regulation; and
- Supporting a sound and stable monetary policy.

Conditions are now in place for a sustained era of national prosperity. But, there is a major threat looming on the horizon: the Federal deficit. If this deficit is not brought under control, we risk losing all we've achieved—and more.

We cannot let this happen. Therefore, the budget I am presenting has as its major objective setting the deficit on a downward path to a balanced budget by 1991. In so doing, my budget meets or exceeds the deficit reduction targets set out in the Balanced Budget and Emergency Deficit Control Act, commonly known for its principal sponsors as Gramm-Rudman-Hollings.

BUDGET SUMMARY

(In billions of dollars)

	1985	1986	1987	1988	1989	1990	1991
Receipts	734.1	777.1	850.4	933.2	996.1	1,058.1	1,124.0
Outlays	946.3	979.9	994.0	1,026.8	1,063.6	1,093.8	1,122.7
Surplus or deficit (-)	-212.3	-202.8	-143.6	-93.6	-67.5	-35.8	1.3
Gramm-Rudman-Hollings deficit targets		-171.9	-144.0	-108.0	-72.0	-36.0	0.0
Difference		30.9	-0.4	-14.4	-4.5	-0.2	-1.3

Note.—Totals include social security, which is off-budget.

At the end of the last session of Congress there emerged a bipartisan consensus that something had to be done about the deficit. The result—Gramm-Rudman-Hollings—committed both the President and the Congress to a fixed schedule of progress. By submitting this budget, I am abiding by the law and keeping my part of the bargain.

This budget shows, moreover, that eliminating the deficit is possible *without* raising taxes, *without* sacrificing our defense preparedness, and *without* cutting into legitimate programs for the poor and the elderly. A tax increase would jeopardize our economic expansion and might well prove counterproductive in terms of its

effect on the deficit. We can hardly back away from our defense build-up without creating confusion among friends and adversaries alike about our determination to maintain our commitments and without jeopardizing our prospects for meaningful arms control talks. And frankly we must not break faith with those poor and elderly who depend on Federal programs for their security.

THE DEFICIT AND ECONOMIC GROWTH

Until the Second World War, the Federal budget was kept in balance or ran a surplus during peacetime as a matter of course. But in the early 1960s this traditional fiscal discipline and political rectitude began to break down. We have run deficits during 24 of the last 25 years. In the past ten years, they have averaged 2.5% of GNP. But last year the deficit was over 5% of GNP. This trend is clearly in the wrong direction and must be reversed.

Last year's deficit amounted to nearly \$1,000 for every man, woman, and child in the United States. To eliminate the deficit solely by increasing taxes would mean imposing an extra \$2,400 burden on each American household. But taxes are already higher relative to GNP than they were during the 1960s and early 1970s—before inflation pushed them to levels that proved insupportable. The American people have made it clear they will not tolerate a higher tax burden. Spending is the problem—not taxes—and spending must be cut.

The program of spending cuts and other reforms contained in my budget will lead to a balanced budget at the end of five years and will thus remove a serious impediment to the continuation of our economic expansion. As this budget shows, such reforms can be accomplished in an orderly manner, without resorting to desperate measures.

Inappropriate and outmoded programs, and activities that cannot be made cost effective, must be ended. Activities that are essential, but that need not be carried out by the Federal Government, can be placed in the private sector or, if they are properly public in nature, turned over to State and local governments. As explained in the Management Report I am also submitting today, efficiencies can be realized through improved management techniques, increased productivity, and program consolidations.

The need to cut unnecessary Federal spending and improve management of necessary programs must be made a compelling guide to our policy choices. The result will be a leaner, better integrated, more streamlined Federal Government—stripped of marginal, non-essential and inappropriate functions and activities, and focusing its energies and resources entirely on its proper tasks and constitutional responsibilities. That way, resources will be allocated more efficiently—those things best done by government will be done by

government; those things best done by the private sector will be directed by the marketplace.

The Balanced Budget and Emergency Deficit Control Act (Gramm-Rudman-Hollings) requires that spending be reduced in accord with a prescribed formula if projected deficits exceed the predetermined targets. This mechanism will operate in a limited fashion during the current fiscal year. However, we should avoid such across-the-board cuts in the future, and they will not be necessary if Congress adopts this budget. Achieving budget savings by taking into account relative priorities among programs is a much better way than resorting to an arbitrary formula. The latter could dangerously weaken vital programs involving the national security or public health and safety, while leaving marginal programs substantially intact.

If the spending cuts and other reforms proposed in this budget are approved, the Federal deficit will be reduced by \$166 billion over the next three years. This represents about \$700 for every individual American and about \$1,900 for every household. I believe this is the appropriate way to deal with the deficit: cut excessive Federal spending rather than attack the family budget by increasing taxes, or risk a deterioration in our national security posture, or break faith with the dependent poor and elderly.

RESTRUCTURING AND RETURNING THE FEDERAL GOVERNMENT TO ITS PROPER ROLE

The task of reducing the deficit must be pursued with an eye toward narrowing the current wide scope of Government activities to the provision of those, but only those, necessary and essential services toward which all taxpayers should be contributing—and providing them as efficiently as possible. This is the underlying philosophy that I have used in shaping this year's budget. Let me explain:

High priority programs should be adequately funded.—Despite the very tight fiscal environment, this budget provides funds for maintaining—and in some cases expanding—high priority programs in crucial areas of national interest. Necessary services and income support for the dependent poor and the elderly receive significant funding in this budget. So do other programs of national interest, including drug enforcement, AIDS research, the space program, nonmilitary research, and national security.

While national security programs continue to be one of my highest priorities, they have not been exempt from general budgetary stringency. Last summer I reluctantly agreed with Congress to scale back the planned growth of defense appropriations to a zero real increase for 1986 and only a 3% real increase each year thereafter. Congressional action on 1986 appropriations and the

subsequent sequestration for 1986 under Gramm-Rudman-Hollings have cut defense budget authority well below last year's level. The budget I am submitting would return defense funding to a steady, well-managed growth pattern consistent with the program levels agreed to in last year's budget resolution and consistent with what the country needs in order to provide for our national security.

During the past five years, we have reversed the decline in defense spending and have made significant progress in restoring our military capabilities. The moderate increases that are now requested are necessary to maintain this progress and enable us to move forward with meaningful arms reduction negotiations with the Soviet Union.

Unnecessary programs are no longer affordable.—Some government programs have become outmoded, have accomplished their original purpose, represent an inappropriate area for Federal involvement in the first place, or are marginal in the current tight budgetary environment. If it would not be appropriate or feasible for the private sector or for State or local governments to assume such functions, this budget proposes that programs of this variety be terminated immediately, phased out in an orderly manner, or eliminated when their legal authority expires. Examples include Small Business Administration credit programs, Amtrak grants, Urban Development Action Grants, the Appalachian Regional Commission, the Economic Development Administration, the Interstate Commerce Commission, Maritime Administration loan guarantees, education subsidies for health professionals, the work incentives program, and subsidies for air carriers.

Many other programs should be reduced to a more appropriate scale.—Some Federal programs have become overextended, misdirected, or operate on too expansive a scale given the current tight budgetary environment. This budget proposes reforms to limit the costs and future growth of medicare and medicaid, subsidized housing, Civil Service pensions and health benefits, postal subsidies, interstate highway grants, the Forest Service, and many other programs.

The Government should not compete with the private sector.—Traditionally, governments supply the type of needed services that would not be provided by the private marketplace. Over the years, however, the Federal Government has acquired many commercial-type operations. In most cases, it would be better for the Government to get out of the business and stop competing with the private sector, and in this budget I propose that we begin that process. Examples of such "privatization" initiatives in this budget include sale of the power marketing administrations and the naval petrole-

um reserves; and implementation of housing and education voucher programs. I am also proposing the sale of unneeded assets, such as loan portfolios and surplus real estate, and contracting out appropriate Federal services.

Many services can be provided better by State and local governments.—Over the years, the Federal Government has preempted many functions that properly ought to be operated at the State or local level. This budget contemplates an end to unwarranted Federal intrusion into the State and local sphere and restoration of a more balanced, constitutionally appropriate, federalism with more clearly delineated roles for the various levels of government. Examples include new consolidations of restrictive small categorical grant programs into block grants for transportation and environmental protection, at reduced Federal costs. Continued funding is maintained for existing block grants for social services, health, education, job training, and community development.

Administration of the agricultural extension service should be turned over to State and local governments. Also, the Federal Government should get out of the business of paying for local sewage treatment systems, local airports, local law enforcement, subsidies to State maritime schools, and local coastal management.

Remaining Federal activities should be better managed.—As we proceed with the deficit reduction process over the next several years, it is important that all remaining Federal operations be well managed and coordinated to avoid duplication, reduce costs, and minimize regulatory burdens imposed on the private sector. Management efficiencies must accompany the process of developing a leaner, more carefully focused Federal role. We can no longer afford unnecessary overhead and inefficiencies when we are scaling back the role and cost of the Federal Government.

Substantial savings in overhead costs have been achieved under provisions of the Deficit Reduction Act of 1984. As described in my Management Report, more savings are possible, and these effects are incorporated in this budget. Outmoded, inefficient systems of agency cash and credit management are being replaced; administrative policies and procedures, approaches to automatic data processing, and agency field structures will be streamlined and upgraded; and waste, fraud, and abuse will be further reduced. All these initiatives, part of our Reform '88 program, will take advantage of efficiencies made possible by modern management techniques, improved communications, and new information technology. We shall run the Federal Government on a business-like basis—improving service delivery and reducing taxpayer costs.

Administration of Federal agencies will be made more efficient through the adoption of staffing standards, automation of manual

processes, consolidation of similar functions, and reduction of administrative overhead costs. A program to increase productivity by 20% by 1992 in all appropriate Government functions is being instituted, and a major effort is proposed to revamp our outmoded management of a \$250 billion Federal credit portfolio. This effort will include establishing prescreening, origination fees, administration and penalty charges, use of collection agencies, charging appropriate interest rates, and the sale of loan portfolios.

Our management improvement program will result in a leaner and more efficient Federal structure and is described in greater detail in my separate Management Report. Improving the management of the Government must be accorded a crucial role and the priority it deserves.

We must also reduce unnecessary costs and burdens on the non-federal sector and have already made considerable progress in reducing the costs imposed on businesses and State and local governments by Federal regulations. These savings are estimated to total \$150 billion over a 10-year period. We have reduced the number of new regulations in every year I have been in office and have eliminated or reduced paperwork requirements by over 500 million hours. In addition, regulations are now more carefully crafted to achieve the greatest public protection for the least cost, and wherever possible to use market forces instead of working against them.

Finally, user fees should be charged for services where appropriate.—Those who receive special benefits and services from the Federal Government should be the ones to bear the costs of those services, not the general taxpayer. Accordingly, this budget imposes fees and premiums for Federal guarantees of loans, and imposes user fees and charges for Federal cost recovery for meat and poultry inspection, National park and forest facilities, harbor and inland waterway use, Coast Guard and Customs inspections, and for many other services.

REFORM OF THE BUDGET PROCESS

Over the years, Federal spending constituencies have become increasingly powerful. In part because of their strong and effective advocacy, Congress has become less and less able to face up to its budgetary responsibilities. The Congressional budget process is foundering; last year it fell apart time and time again. The budget resolution and appropriations bills were months late in passing, and few real deficit reductions were achieved.

Gramm-Rudman-Hollings offers a significant opportunity to avoid many of these problems in the future. That act not only sets deficit targets leading to a balanced budget by 1991, it provides a

mechanism for automatic spending cuts and incorporates certain reforms in the budget process itself. But Gramm-Rudman-Hollings does not go far enough in this regard. To meet the clear need for a greatly strengthened budget process, I propose a number of additional reform measures.

As before, I ask Congress to pass a balanced budget amendment to the Constitution. In addition, I continue to seek passage of a line item veto—authority now possessed by 43 of the Nation's governors. I also urge, for 1988 and beyond, changing the budget resolution to a joint resolution subject to Presidential signature and establishing binding expenditure subcategories within the resolution budget totals. Moreover, I urge that serious study be given to proposals for multiyear appropriations and to the development of a capital budget.

As I have pointed out time and again, there's not a State in the Union that doesn't have a better budget process than the Federal Government. We can—and must—do better.

CONCLUSION

As I said in my address to Congress yesterday, the State of the Union is strong and growing stronger. We've had some extraordinarily good years, and our economy is performing well, with inflation coming under control. Economic growth and investment are up, while interest rates, tax rates, and unemployment have all come down substantially. Our national security is being restored. The proliferation of unnecessary and burdensome Federal regulations has been halted. A significant beginning has been made toward curbing the excessive and unsustainable growth of domestic spending. Improving the management of the Government has been given priority and is achieving results. I think most Americans would agree that America is truly on the move!

The large and stubbornly persistent budget deficit remains as a dark and threatening cloud on the horizon. It threatens our prosperity and our hopes for continued healthy economic growth.

Congress has recognized this threat. It has mandated a gradual, orderly movement to a balanced budget over the next five years. The proposals in this budget are a blueprint for achieving those targets while preserving legitimate programs for the aged and needy, providing for our national security, and doing this without raising taxes.

I realize it will be difficult for elected officials to make the hard choices envisioned in this budget. But we must find the political will to face up to our responsibilities and resist the pleadings of special interests whose "era of power" in Washington must be brought to an end—for taxpayers as a whole can no longer be expected to carry them on their backs. All this will call for statesmanship of a high order. We must all realize that the deficit problem is also an opportunity—an opportunity to construct a new, leaner, better focused, and better managed Federal structure. Let's do it.

I look forward to working with Congress on meeting these formidable challenges. It is our job. Let's get on with it.

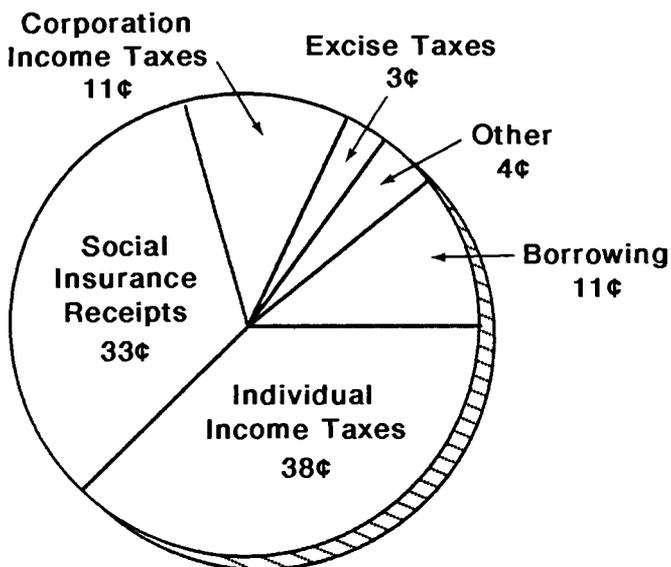
RONALD REAGAN

FEBRUARY 5, 1986

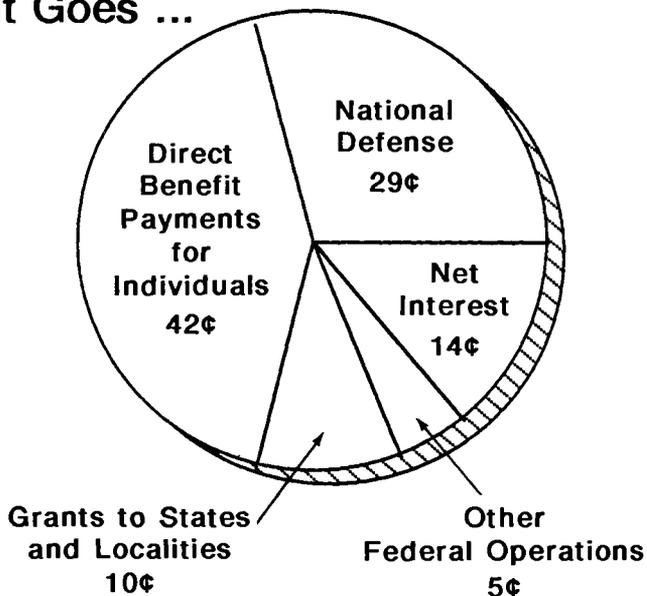
The Federal Government Dollar

Fiscal Year 1988 Estimate

Where It Comes From ...



Where It Goes ...



THE BUDGET MESSAGE OF THE PRESIDENT

*To the Speaker of the House of Representatives and the
President of the Senate:*

The current economic expansion, now in its 50th month, is already one of the longest of the postwar era and shows promise of continuing to record length. This has not been due simply to chance—it is the result of successful policies adopted during the past 6 years. Disposable personal income is at an all-time high and is still rising; total production and living standards are both increasing; employment gains have been excellent. Inflation, which raged at double-digit rates in 1980, has been reduced dramatically. Defense capabilities, which had been dangerously weakened during the 1970's, have been substantially rebuilt, restoring a more adequate level of national security. An insupportable growth in tax burdens and Federal regulations has been halted, an intolerably complex and inequitable income tax structure has been radically reformed, and the largest management improvement program ever attempted is in full swing in all major Federal agencies. It has been a good 6 years.

Now in its 5th year, the current expansion already has exceeded 5 of the 7 previous postwar expansions in duration, and leading economic indicators point to continued growth ahead. Our policies have worked. Let me mention a few highlights of the current economic expansion:

- In the past 4 years 12.4 million new jobs have been created, while the total unemployment rate has fallen by 3.7 percentage points. By comparison, jobs in other developed countries have not grown significantly, and unemployment rates have remained high.
- Inflation, which averaged 10.3 percent a year during the 4 years before I came to office, has averaged less than a third of that during the last 4 years—3.0 percent; inflation in 1986, at about 1 percent, was at its lowest rate in over two decades.
- The prime rate of interest, and other key interest rates, are less than half what they were in 1981.
- Between 1981 and 1986, numerous changes in the tax code, including a complete overhaul last year, have simplified reporting, made the tax law more equitable, and significantly lowered tax rates for individuals and corporations. Six million low-income taxpayers are being removed from the income tax

rolls. The inhibitive effect of our tax code on individual initiative has been reduced dramatically. Real after-tax personal income has risen 15 percent during the last 4 years, increasing our overall standard of living.

- Our defense capabilities have been strengthened with modernized equipment and successful recruiting and retention of higher caliber personnel; the readiness, training, and morale of our troops has been improved.
- After years of unsustainably rapid growth, Federal spending for domestic programs other than entitlements has been held essentially flat over the last 4 years.
- Since 1981, the amount of time spent by the public filling out forms required by the Federal Government has been cut by over 600 million hours, and the number of pages published annually in the *Federal Register* has been reduced by over 45 percent.
- Our continuing fight against waste, fraud, and abuse in Government programs has paid off, as the President's Council on Integrity and Efficiency has saved \$84 billion in funds that have been put to more efficient use.
- Finally, Federal agencies have instituted the largest management improvement program ever attempted to bring a more business-like approach to Government.

The dramatic improvement in the performance of our economy stemmed from steadfast adherence to the four fundamental principles of the economic program I presented in February 1981:

- limiting the growth of Federal spending;
- reducing tax burdens;
- relieving the economy of excessive regulation and paperwork; and
- supporting a sound and stable monetary policy.

BUDGET SUMMARY

(In billions of dollars)

	1986	1987	1988	1989	1990	1991	1992
Receipts.....	769.1	842.4	916.6	976.2	1,048.3	1,123.2	1,191.2
Outlays.....	989.8	1,015.6	1,024.3	1,069.0	1,107.8	1,144.4	1,178.9
Surplus or deficit (—).....	—220.7	—173.2	—107.8	—92.8	—59.5	—21.3	12.3
Gramm-Rudman-Hollings deficit targets.....	—171.9	—144.0	—108.0	—72.0	—36.0	0.0	0.0
Difference.....	48.8	29.2	—0.2	20.8	23.5	21.3	—12.3

Note.—Totals include social security, which is off-budget.

NEED FOR DEFICIT REDUCTION

The foundation has been laid for a sustained era of national prosperity. But a major threat to our future prosperity remains:

the Federal deficit. If this deficit is not brought under control by limiting Government spending, we put in jeopardy all we have achieved. Deficits brought on by continued high spending threaten the lower tax rates incorporated in tax reform and inhibit progress in our balance of trade.

We cannot permit this to happen. Therefore, one of the major objectives of this budget is to assure a steady reduction in the deficit until a balanced budget is reached.

This budget meets the \$108 billion deficit target for 1988 set out in the Balanced Budget and Emergency Deficit Control Act, commonly known for its principal sponsors as Gramm-Rudman-Hollings. Gramm-Rudman-Hollings committed both the President and Congress to a fixed schedule of progress toward reducing the deficit. In submitting this budget, I am keeping my part of the bargain—and on schedule. I ask Congress to do the same. If the deficit reduction goals were to be abandoned, we could see unparalleled spending growth that this Nation cannot afford.

This budget shows that eliminating the deficit over time is possible *without* raising taxes, *without* sacrificing our defense preparedness, and *without* cutting into legitimate programs for the poor and the elderly, while at the same time providing needed additional resources for other high priority programs.

DEFICIT REDUCTION IN 1988

Although the deficit has equalled or exceeded 5 percent of the gross national product (GNP) in each of the past 4 years, each year I have proposed a path to lower deficits—involving primarily the curtailment of unnecessary domestic spending. Congress, however, has rejected most of these proposals; hence, our progress toward reducing the deficit has been much more modest than it could have been.

This year there appears to be a major turn for the better. The 1987 deficit is estimated to be about \$48 billion less than in 1986 and should decline to less than 4 percent of GNP. As the economy expands, Federal receipts will rise faster than the increase in outlays Congress enacted for the year.

However, there is no firm guarantee that progress toward a steadily smaller deficit and eventual budget balance will continue. On a current services basis the deficit will continue to decline over the next 5 years, but this decline is gradual and vulnerable to potential fiscally irresponsible congressional action on a multitude of spending programs. It is also threatened by the possibility of a less robust economic performance than is projected, for that projection is based on the assumption that the necessary spending cuts will be made.

This 1988 budget can deal the deficit a crucial blow. If the proposals in this budget are adopted and if the economy performs according to the budget assumptions for growth and inflation, then for the second consecutive year the deficit should shrink substantially, by \$65 billion, and thus decline to less than 2½ percent of GNP. Reducing the deficit this far would bring it within the range of our previous peacetime experience and bring our goal of a balanced budget much closer to realization.

Moreover, if Congress adopts the proposals contained in this budget, it will ensure additional deficit reductions in future years, because in many cases the savings from a given action, although small in 1988, would mount in later years. Given the good start made in 1987, Congress has an opportunity this year—by enacting this budget—to put the worst of the deficit problem behind us.

Adopting the spending reductions and other reforms proposed in this budget would reduce the Federal deficit an average \$54 billion annually for the next 3 years. This represents \$220 each year for every individual American and about \$600 for every household. I believe this is the appropriate way to deal with the deficit: cutting excessive Federal spending rather than attacking the family budget by increasing taxes, weakening our national security, breaking faith with the poor and the elderly, or ignoring the requirements for additional resources for other high priority programs.

A MORE COMPETITIVE, PRODUCTIVE AMERICA

The task of deficit reduction is a formidable one—but it can and should be achieved with serious attention to the effects on America's economy, businesses, State and local governments, social organizations, and individual citizens. Reducing the deficit will reduce the burden the Federal Government places on private credit markets. The specific deficit reduction measures proposed in this budget would also help make our economy more competitive—and more productive. These objectives have been major considerations in the formulation of this budget.

High priority programs must be funded adequately. Despite the very tight overall fiscal environment, this budget provides adequate funds for maintaining and, in selected cases, expanding high priority programs in key areas of national interest. For example:

- essential services and income support for the aged and needy are expanded;
- the prevention, treatment, and research efforts begun in my 1987 drug abuse initiative are continued, while resources devoted to drug law enforcement have tripled since my administration began;
- the budget allocates \$85 million to more intensive health care for those with the highest incidence of infant mortality;

- over half a billion dollars is provided for AIDS research and education in 1988—a 28 percent increase above the 1987 level and more than double our 1986 effort (an additional \$100 million is provided for AIDS treatment and blood screening by the Veterans Administration and the Department of Defense);
- building upon the Nation's preeminence in basic biomedical research, the budget seeks funding for the full multiyear costs of biomedical research grants made by the National Institutes of Health;
- a \$200 million increase over the 1987 level is proposed for compensatory education for educationally disadvantaged children;
- current ineffective programs intended to assist dislocated workers are replaced by an expanded billion-dollar program carefully designed to help those displaced from their jobs move quickly into new careers;
- a 68 percent increase in funding is provided to permit the Federal Aviation Administration to modernize the Nation's air traffic control system; this includes the procurement of doppler radars capable of detecting severe downdrafts that imperil landings and takeoffs at airports where this is a hazard;
- for 1988, \$400 million is provided to carry out newly enacted immigration reform legislation;
- substantial increases in funding for clean coal technology demonstrations, as well as research on acid rain formation and environmental effects, are provided to address the acid rain problem; and
- a new civil space technology initiative, together with previously planned increases to construct a space station, develop a national aerospace plane, and foster the commercial development of space, are provided in this budget.

Restoring our national security also has been one of my highest priorities over the past 6 years due to the serious weakness arising from severe underfunding during the middle and late 1970's. Nonetheless, defense and international programs have not escaped the effects of fiscal stringency. The defense budget actually has declined in real terms in each of the past 2 years. This trend cannot be allowed to continue. I am proposing in this budget a 3 percent real increase over last year's appropriated level. This request—some \$8 billion less than last year's—is the minimum level consistent with maintaining an adequate defense of our Nation.

Likewise, my request for our international affairs programs is also crucial to our effort to maintain our national security. I urge

Congress not to repeat last year's damaging cuts, but rather to fund these programs fully.

The incentive structure for other Federal programs should be changed to promote efficiency and competitiveness. One of the problems with many Federal programs is that they provide payments without encouraging performance or efficiency. They are perceived to be "free" and, therefore, there is potentially unlimited demand. This has to be changed—and this budget proposes creating needed incentives in critical areas.

Our farm price support programs, under the Food Security Act of 1985, are proving much too costly—half again as costly as estimated when the bill was enacted just one year ago. The \$25 billion being spent on farm subsidies in 1987 is 14 percent of our total Federal deficit and equivalent to taking \$415 of each nonfarm family's taxes to support farmers' incomes—over and above the amount that price supports add to their grocery bills. Some of the provisions of the Act encourage farmers to overproduce just to receive Federal benefits. Other provisions give the greatest benefits to our largest and most efficient agricultural producers instead of to those family farmers most in need of help. My administration will propose amendments to the Food Security Act to focus its benefits on the full-time family farmer by placing effective limitations on the amount paid to large producers and removing the incentive for farmers to overproduce solely to receive Federal payments.

Reform of the medicare physician payment system is also proposed. Under the proposals, medicare would pay for radiology, anesthesiology, and pathology (RAP) services based on average area costs instead of inflationary fee-for-service reimbursements. The current fee-for-service payment distorts incentives and induces inappropriate billing for unneeded services. This initiative would remove the distortions caused by medicare's current reimbursement rules, eliminating a key barrier preventing the restoration of traditional arrangements between RAP physicians and hospital staffs.

The budget proposes continued increases in federally supported basic research that will lead to longer term improvements in the Nation's productivity and global competitiveness. For example, the budget projects a doubling within 5 years of the National Science Foundation's support for academic research. I also propose to increase support for training future scientists and engineers, and to foster greater technology transfer from Government to industry.

Another way of attaching a "value" to Government-provided services—and an incentive to use them only as needed—is to charge user fees where appropriate. Those who receive special Federal services—not the general taxpayer—should bear a greater

share of the costs of those services. Accordingly, this budget imposes fees for Federal lending activities, for meat and poultry inspection, for National park and forest facilities, for Coast Guard services, for Customs inspections, and for many other services.

The Government should stop competing with the private sector. The Federal Government interferes with the productivity of the private sector in many ways. One is through borrowing from the credit markets to finance programs that are no longer needed—as in the case of the rural housing insurance fund, direct student financial assistance, urban mass transit discretionary grants, vocational education grants, the Federal Crop Insurance Corporation fund, sewage plant construction grants, justice assistance grants, the Legal Services Corporation, and rural electrification loans. I am proposing in this budget that we terminate these programs and rely instead on private or State and local government provision of these services.

The budget also proposes that a number of programs that have real utility be transferred back to the private sector, through public offerings or outright sales. Following our successful effort to authorize sale of Conrail, I am now proposing the sale of the Naval Petroleum Reserves, AMTRAK, the Alaska Power Administration, the helium program, and excess real property. In addition, I am proposing legislation to authorize study of a possible divestiture of the Southeastern Power Administration. These “privatization” efforts continue to be a high priority of my administration and, I believe, will result in increased productivity and lower total costs of providing these services. The Federal Government needs to provide essential services that are truly public in nature and national in scope. It has no business providing services to individuals that private markets or their State or local governments can provide just as well or better.

The Federal Government should depend more on the private sector to provide ancillary and support services for activities that remain in Federal hands. The budget proposes that the work associated with over 40,000 Federal positions be contracted out to the private sector as yet another way to increase productivity, reduce costs, and improve services.

Federal credit programs should operate through the private markets and reveal their true costs. The Federal Government provides credit for housing, agriculture, small business, education, and many other purposes. Currently, over a trillion dollars of Federal or federally assisted loans are outstanding. Including lending of Government-sponsored enterprises, federally assisted lending amounted to 14 percent of all lending in U.S. credit markets in 1985.

Under current treatment, loan guarantees appear to be “free”; they do not affect the budget until and unless borrowers default. Direct loans are counted as outlays when they are made, but as “negative outlays” when they are repaid; thus, direct loans seem “free” too, inasmuch as it is presumed they will be repaid. But neither direct loans nor loan guarantees are free. Besides the better terms and conditions a borrower gets from the Government, there is the matter of default. When a borrower does not repay a direct loan, the negative outlay does not occur, and this is a subsidy implicit in the original loan transaction. When a borrower defaults on a guaranteed loan, the Government has to make good on repayment—also a program subsidy.

Since these effects are poorly understood and lead to grave inefficiencies in our credit programs, we will ask Congress to enact legislation whereby the true cost to the economy of Federal credit programs would be counted in the budget. By selling a substantial portion of newly made loans to the private sector and reinsuring some newly made guarantees, the implicit subsidy in the current practice will become explicit. This reform will revolutionize the way Federal credit activities are conducted.

The private sector will also be increasingly involved in the management of our huge portfolio of outstanding loans and loan guarantees. Delinquent Federal borrowers will be reported to private credit bureaus, and private loan collection agencies will be used to help in our collection efforts. The Internal Revenue Service (IRS) will expand its “offsetting” of refunds to pay off delinquent Federal debts, and Federal employees who have not paid back Federal loans will have their wages garnisheed.

Increased role for State and local governments. Over the past 6 years I have sought to return various Federal services to State and local governments—which are in a much better position to respond effectively to the needs of the recipients of these services. To me, this is a question of reorganizing responsibilities within our Federal system in a manner that will result in more productive delivery of the services that we all agree should be provided. Thus, this budget phases out inappropriate Federal Government involvement in local law enforcement, sewage treatment, public schools, and community and regional development. Transportation programs will be consolidated or States will be given greater flexibility in the use of Federal funds for highways, mass transit, and airports.

Federal regulations must be reduced even further to improve productivity. My administration will continue the deregulation and regulatory relief efforts that were begun in 1981. The Task Force on Regulatory Relief, headed by the Vice President, has been reinstated. In the past, excessive Federal regulations and related paperwork have stifled American productivity and individual freedom.

We must continue our efforts to streamline the regulatory process and to strike the proper balance between necessary regulation and associated paperwork on the one hand, and the costs of these requirements on the other.

Federal activities should be better managed. The American people deserve the best managed Federal Government possible. Last year, I initiated the Federal Government Productivity Program, with the goal of improving productivity in selected areas by 20 percent by 1992. A substantial portion of total direct Federal employment falls within the program, including such activities as the Department of Agriculture meat and poultry inspection, Navy aircraft maintenance and repair, social security claims processing, National Park maintenance, operation of Federal prisons, and IRS processing of tax returns.

Credit reform, privatization, productivity improvement, and other proposals will be described in more detail in the *Management Report* to be issued this month. It will also identify further measures to reduce waste, fraud, and abuse; to improve management of the Government's \$1.7 trillion cashflow; to institute compatible financial management systems across all Federal agencies; and other initiatives to improve the management of Government operations. These ambitious management reform undertakings, called "Reform '88," constitute the largest management reform effort ever attempted.

The budget also proposes a new approach to paying Federal employees who increase their productivity. I ask that Congress approve a new plan to transform the current system of virtually automatic "within-grade" salary increases for the roughly 40 percent of employees eligible each year for these 3 percent hidden pay raises to one that is "performance-oriented". This will give Federal employees stronger incentives to improve service delivery.

I include with this budget my recommendations for increases in executive level pay for the executive, legislative, and judicial branches of the Federal Government. The Quadrennial Commission report submitted to me on December 15, 1986 documented both the substantial erosion in the real level of Federal executive pay that has occurred since 1969 and the recruitment and retention problems that have resulted, especially for the Federal judiciary. The Commission is to be commended for its diligent and conscientious effort to address the complicated and complex problems associated with Federal pay levels.

Every one of the Quadrennial Commissions that have met over the past 18 years has recognized that a pay increase for key Federal officials was necessary. Each Commission concluded that pay for senior Government officials fell far behind that of their counterparts in the private sector. They also understood that we cannot afford a

Government composed primarily of those who are wealthy enough to serve. Unfortunately, the last major Quadrennial Commission pay adjustment was in 1977—a decade ago.

However, I recognize that we are under mandated efforts to reduce the Federal deficit and hold down the costs of Government to the absolute minimum level. In this environment, I do not believe it would be appropriate to implement fully the Quadrennial Commission recommendations.

Accordingly, I have decided to propose a pay increase, but have cut substantially the recommendations made by the Quadrennial Commissioners in their report to me last month. Moreover, I have decided to establish a Career Manager Pay Commission to review and report to me by next August on appropriate pay scales for our elite corps of career Government managers. The pay increases I am proposing to Congress, plus the results of this new Commission, should place Government compensation on a fairer and more comparable footing.

PEACE THROUGH STRENGTH

I have become convinced that the only way we can bring our adversaries to the bargaining table for arms reduction is to give them a reason to negotiate—while, at the same time, fulfilling our responsibility to our citizens and allies to provide an environment safe and secure from aggression.

We have built our defense capabilities back toward levels more in accord with today's requirements for security. Modest and sustained growth in defense funding will be required to consolidate the real gains we have made. Because of severe fiscal constraints, we are proceeding at a slower pace than I originally planned, and the budget I propose provides the minimum necessary to ensure an adequate defense.

I am also submitting, for the first time, a two-year budget for National Defense. This will permit greater stability in providing resources for our defense efforts and should lead to greater economy in using these resources.

BUDGET PROCESS REFORM

The current budget process has failed to provide a disciplined and responsible mechanism for consideration of the Federal budget. Budget procedures are cumbersome, complex, and convoluted. They permit and encourage a process that results in evasion of our duty to the American people to budget their public resources responsibly. Last year Congress did not complete action on a budget for 8 months and 2 weeks—2 weeks past the statutory deadline. Except for the initial report of the Senate Budget Committee, Congress missed every deadline it had set for itself just 9 months earlier. In

the end, Congress passed a yearlong, 389-page omnibus appropriations bill full of excessive and wasteful spending. Because Congress had not completed action on the annual appropriations bills, at one point I was compelled by law to initiate a shutdown of Federal Government activities. Such abrogation of a responsible budget process not only discourages careful, prudent legislation—it encourages excessive spending and waste.

Furthermore, since I, as President, do not have a line-item veto, I had to ignore the many objectionable features of the omnibus appropriations legislation and sign it to avoid a Federal funding crisis. I am sure that many Members of Congress do not approve of this method of budgeting the Federal Government.

Last Fall's funding crisis and its slap-dash resolution are only one of the most obvious manifestations of the flaws in the system. Congress passes budget resolutions (without the concurrence of the President) based on functions; it considers 13 separate, but related, appropriations bills based on agencies, not functions; it develops a reconciliation bill; it passes authorizing legislation, sometimes annually; and it enacts limits on the public debt. The words alone are obscure and confusing; the process behind it is chaotic. The process must be streamlined and made more accountable.

Shortly, I will outline specific reforms designed to make the process more efficient and increase accountability, so that we can give the American people what they deserve from us: a budget that is fiscally responsible and on time.

CONCLUSION

Looking back over the past 6 years, we can feel a sense of pride and satisfaction in our accomplishments. Inflation has been brought under control. Growth and investment are up, while interest rates, tax rates, and unemployment rates have all come down substantially. A foundation for sustained economic expansion is now in place. Our national security has been restored to more adequate levels. The proliferation of unnecessary and burdensome Federal regulations has been halted. A significant beginning has been made toward curbing the excessive growth of domestic spending. Management of the Government is being improved, with special emphasis on productivity.

Important tasks, however, still remain to be accomplished. The large and stubbornly persistent budget deficit has been a major source of frustration. It threatens our prosperity and our hopes for continued economic growth.

Last year, the legislative and executive branches of Government responded to this threat by mandating gradual, orderly progress toward a balanced budget over the next 4 years. The proposals outlined here achieve the 1988 target while preserving legitimate

programs for the aged and needy, providing for adequate national security, devoting more resources to other high-priority activities, and doing this without raising taxes.

This budget presents hard choices which must be faced squarely. Congress must not abandon the statutory deficit targets of Gramm-Rudman-Hollings. Honoring the provisions and promises of this legislation offers the best opportunity for us to escape the chronic pattern of deficit spending that has plagued us for the past half century. We must realize that the deficit problem is also an opportunity of a different kind—an opportunity to construct a new, leaner, better focused, and better managed Federal structure supporting a more productive and more competitive America.

RONALD REAGAN

JANUARY 5, 1987

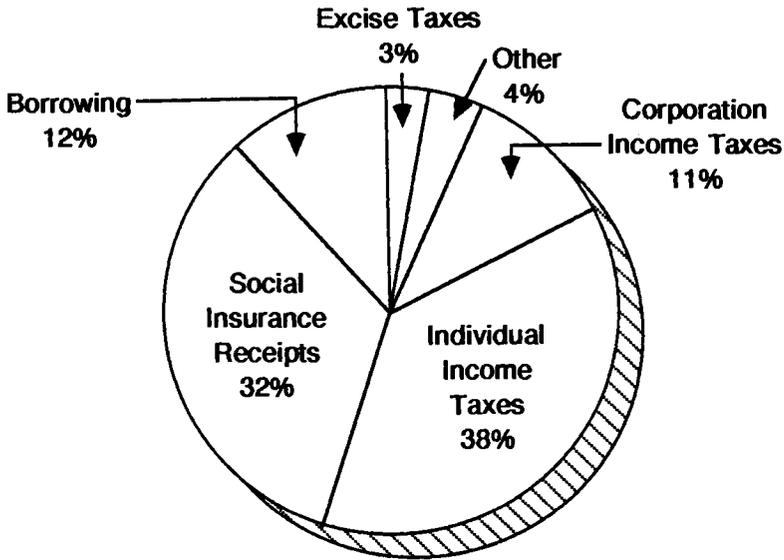
PART 1

**THE BUDGET MESSAGE
OF THE
PRESIDENT**

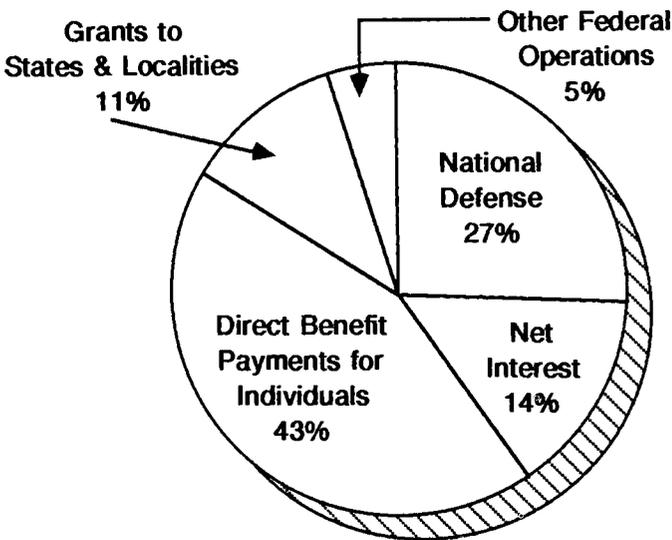
1-1

The Federal Government Dollar Fiscal Year 1989 Estimate

Where It Comes From ...



Where It Goes ...



THE BUDGET MESSAGE OF THE PRESIDENT

To the Congress of the United States:

As we consider the state of our Nation today, we have much cause for satisfaction. Thanks to sound policies, steadfastly pursued during the past 7 years, America is at peace, and our people are enjoying the longest peacetime economic expansion in our Nation's history.

By reordering priorities so that we spend more on national security and less on wasteful or unnecessary Federal programs, we have made freedom more secure around the world and have been able to negotiate with our adversaries from a position of strength. By pursuing market-oriented economic policies, we have uncorked the genie of American enterprise and created new businesses, more jobs, improved production, and widespread prosperity. And we have done all this without neglecting the poor, the elderly, the infirm, and the unfortunate among us.

SEVEN YEARS OF ACCOMPLISHMENT

Let me note a few of the highlights from our Administration's record of accomplishment:

- The current expansion, now in its sixty-third month, has outlasted all previous peacetime expansions in U.S. history. Business investment and exports are rising in real terms, foreshadowing continued economic growth this year and next.
- Since this expansion began, 15 million new jobs have been created, while the unemployment rate has fallen by 5 percentage points—to 5.7 percent, the lowest level in nearly a decade. By comparison, employment in other developed countries has not grown significantly, and their unemployment rates have remained high.
- Inflation, which averaged 10.4 percent annually during the 4 years before I came to office, has averaged less than a third of that during the past 5 years.
- The prime interest rate was 21.5 percent just before I came into office; it is now 8.5 percent; the mortgage rate, which was 14.9 percent, is now down to 10.2 percent.
- Since 1981, the amount of time spent by the public filling out forms required by the Federal Government has been cut by hundreds of millions of hours annually, and the number of

pages of regulations published annually in the *Federal Register* has been reduced by over 45 percent.

- Between 1981 and 1987, changes in the Federal tax code, including a complete overhaul in 1986, have made the tax laws more equitable, significantly lowered earned income tax rates for many individuals and corporations, and eliminated the need for 4.3 million low-income individuals or families to file tax forms.
- At the same time, real after-tax personal income has risen 15 percent during the past 5 years, increasing our overall standard of living.
- The outburst of spending for means-tested entitlement programs that occurred in the 1970's has been curbed. Eligibility rules have been tightened to retarget benefits to the truly needy, and significant progress has been made in improving the efficiency and effectiveness of these programs.
- We have begun the process of putting other entitlement programs on a more rational basis. This includes medicare, which was converted from cost-plus financing to a system that encourages competition and holds down costs.
- Federal spending for domestic programs other than entitlements has been held essentially flat over the past 5 years, while basic benefits for the poor, the elderly, and others in need of Federal assistance have been maintained. This is a dramatic improvement over the unsustainably rapid annual growth of these programs that prevailed before 1981.
- The social security system has been rescued from the threat of insolvency.
- Our defense capabilities have been strengthened. Weapons systems have been modernized and upgraded. We are recruiting and retaining higher caliber personnel. The readiness, training, and morale of our troops have been improved significantly. Because we are stronger, enormous progress has been achieved in arms reduction negotiations with the Soviet Union.
- Federal agencies have undertaken a major management improvement program called "Reform '88." This program has two main objectives: to operate Federal agencies in a more business-like manner, and to reduce waste, fraud, and abuse in government programs.
- Some functions of the Federal Government—such as financing waste treatment plants—are being transferred back to State and local governments. In other instances—such as water projects—State and local governments are bearing a larger share of costs, leading to more rational decision-making in these areas.

- Finally, we have made real progress in privatizing Federal activities that are more appropriate for the private sector than government. Notable examples include the sale of Conrail, the long-term lease of National and Dulles Airports, and the auction of billions of dollars in loan portfolios.
- Related to this shift away from the Federal budget are our achievements on cost sharing and user fees, shifting the cost of projects and programs where appropriate to non-Federal sources.

While we have reason to be proud of this record of achievement, we must be vigilant in addressing threats to continued prosperity. One major threat is the Federal deficit.

DEFICIT REDUCTION, THE AGREEMENT, AND G-R-H

If the deficit is not curbed by limiting the appetite of government, we put in jeopardy what we have worked so hard to achieve. Larger deficits brought on by excessive spending could precipitate rising inflation, interest rates, and unemployment. We cannot permit this to happen, and we will not.

BUDGET SUMMARY

(In billions of dollars)

	1987	1988	1989	1990	1991	1992	1993
Receipts.....	854.1	909.2	964.7	1,044.1	1,124.4	1,189.9	1,258.1
Outlays.....	1,004.6	1,055.9	1,094.2	1,148.3	1,203.7	1,241.0	1,281.3
Surplus or deficit (—).....	—150.4	—146.7	—129.5	—104.2	—79.3	—51.1	—23.3
Gramm-Rudman-Hollings deficit targets.....	—144.0	—144.0	—136.0	—100.0	—64.0	—28.0	0.0
Difference.....	6.4	2.7	—6.5	4.2	15.3	23.1	23.3

Note.—Totals include social security, which is off-budget.

The Congress acknowledged the pressing need to reduce the deficit when, in December 1985, it enacted the Balanced Budget and Emergency Deficit Control Act, commonly known for its principal sponsors as the Gramm-Rudman-Hollings (G-R-H) Act. This Act committed both the President and the Congress to a fixed schedule of progress toward balancing the budget.

In 1987, the budget deficit was \$150 billion—down \$71 billion from the record level of \$221 billion reached in 1986. This was also a record decline in the deficit. To some extent, however, this improvement represented one-time factors, such as a high level of receipts in the transitional year of tax reform. Economic forecasters predicted that without action the 1988 and 1989 deficits would be higher than the 1987 level. In order to prevent this, and to preserve and build upon the 1987 deficit-reduction progress in a realistic fashion, last fall the Congress modified the G-R-H Act.

Specifically, it required that the 1988 deficit target be \$144 billion and the target for 1989 be \$136 billion.

Last year, members of my Administration worked with the Leaders of Congress to develop a 2-year plan of deficit reduction—the Bipartisan Budget Agreement. One of the major objectives of the budget I am submitting today is to comply with that agreement—in order to help assure a steady reduction in the deficit until budget balance is achieved.

The Bipartisan Budget Agreement reflects give and take on all sides. I agreed to some \$29 billion in additional revenues and \$13 billion less than I had requested in defense funding over 2 years. However, because of a willingness of all sides to compromise, an agreement was reached that pared \$30 billion from the deficit projected for 1988 and \$46 billion from that projected for 1989.

In submitting this budget, I am adhering to the Bipartisan Budget Agreement and keeping my part of the bargain. I ask the Congress to do the same. This budget does not fully reflect my priorities, nor, presumably, those of any particular Member of Congress. But the goal of deficit reduction through spending reduction must be paramount. Abandoning the deficit reduction compromise would threaten our economic progress and burden future generations.

This budget shows that a gradual elimination of the deficit is possible without abandoning tax reform, without cutting into legitimate social programs, without devastating defense, and without neglecting other national priorities.

Under the Bipartisan Budget Agreement, progress toward a steadily smaller deficit and eventual budget balance will continue, but this projected decline rests on two assumptions: continued economic growth, and implementation of the Agreement. If the economy performs as expected, and if the Bipartisan Budget Agreement reflected in this budget is adhered to, the deficit should decline to less than 3 percent of GNP in 1989. For the first time in several years, the national debt as a proportion of GNP will actually fall. Reducing the deficit and the debt in this manner would bring our goal of a balanced budget and a reduced burden on future generations much closer to realization.

Moreover, adherence to the Agreement, as reflected in this budget, will ensure the achievement of additional deficit reductions in future years, because in many cases the savings from a given action this year will generate deficit savings in subsequent years. Given the good start made in 1987, we have an opportunity this year to put the worst of the deficit problem behind us.

MEETING NATIONAL PRIORITIES

In formulating this budget, I have endeavored to meet national priorities while keeping to the terms of the Bipartisan Budget Agreement and the G-R-H Act. In essence, the Agreement limits the 1988-to-1989 increase in domestic discretionary program budget authority to 2 percent. To address urgent national priorities insofar as possible within this overall 2 percent limit, my budget proposes that some programs—such as those for education, drug enforcement, and technology development—receive larger funding increases, while others are reduced, reformed, or, in some cases, terminated.

High-priority programs must be funded adequately. One of our highest priorities is to foster individual success through greater education and training opportunities. For example:

- I propose an increase of \$656 million over the \$16.2 billion appropriated for 1988 for discretionary programs of the Department of Education. Although State and local governments fund most educational activity, Federal programs provide crucial aid for the poor, the handicapped, and the educationally disadvantaged.
- I have proposed reform of our over-centralized welfare system through State experimentation with innovative alternatives. In addition, my initiative would overhaul current employment and training programs for welfare recipients, and strengthen our national child support enforcement system.
- By emphasizing housing vouchers, I would provide housing assistance to 135,500 additional low-income households in 1989—8 percent more than the 125,000 additional households receiving housing subsidies in 1988.
- Ineffective programs to assist dislocated workers would be replaced by an expanded \$1 billion worker readjustment program (WRAP) carefully designed to help those displaced from their jobs move quickly into new careers.

In addition, I am proposing funds to strengthen U.S. technology and make America more competitive. For example:

- I propose a continued increase in federally supported basic research aimed at longer-term improvements in the Nation's productivity and global competitiveness. This budget would double National Science Foundation support for academic basic research, increase support for training future scientists and engineers, and expedite technology transfer of Government-funded research to industry.
- I would provide \$11.5 billion for space programs, including: essential funding for continued development of America's first permanently manned Space Station; increased support for improving the performance and reliability of the space shuttle; a

major new initiative, the Advanced X-ray Astrophysics Facility, for space science; further support to encourage the commercial development of space; and a new technology effort, Project Pathfinder, designed to develop technologies to support future decisions on the expansion of human presence and activity beyond Earth's orbit, into the solar system.

- I also recommend \$363 million in 1989 to initiate construction of the Superconducting Super Collider (SSC), including \$283 million for construction and \$60 million for supporting research and development. The SSC as currently envisaged will be the largest pure science project ever undertaken. It will help keep this country on the cutting edge of high energy physics research until well into the next century.

This budget also reflects my belief that the health of all of our citizens must remain one of our top priorities:

- I continue to urge enactment of an affordable self-financing insurance program through medicare to protect families from economic devastation caused by catastrophic illness.
- To attack the scourge of AIDS, I propose \$2 billion for additional research, education, and treatment in 1989—a 38 percent increase over the 1988 level and more than double the Federal Government's effort in 1987. This includes \$1.3 billion in funding for the Public Health Service.
- Building upon the Nation's preeminence in basic biomedical research, I seek a 5.1 percent increase for non-AIDS research at the National Institutes of Health;

Our fight against drug abuse must continue, as well as our efforts to protect the individual against crime:

- For expanded law enforcement, including efforts targeted at white collar crime, organized crime, terrorism and public corruption, I propose \$4.5 billion—an increase of 6 percent over 1988.
- For drug law enforcement, prevention, and treatment programs, I propose \$3.9 billion in 1989, a 13 percent increase over the 1988 level.
- To relieve prison overcrowding and adequately house a growing inmate population, I would provide \$437 million—more than double the \$202 million devoted to Federal prison construction in 1988.

Other areas of Federal responsibility receive priority funding in this budget:

- For the Federal Aviation Administration to continue its multi-year program to modernize the Nation's air traffic control systems, I would provide \$1.6 billion—a 44 percent increase over the level of 1988.

- To improve coordination of Federal rural development programs and to redirect funding toward needy rural areas and program recipients, I propose a rural development initiative to be coordinated by the Secretary of Agriculture.
- To carry out the joint recommendations of the U.S. and Canadian Special Envoys on Acid Rain, I recommend total funding of \$2.5 billion for innovative clean coal technology demonstration projects over the period 1988 through 1992.
- I also recommend an expansion of hazardous waste cleanup efforts, with an increase in Superfund outlays of some \$430 million in 1989.
- To continue filling the Strategic Petroleum Reserve (SPR) at the current rate of 50,000 barrels per day, I would provide \$334 million in 1989. Contingent upon the enactment of legislation authorizing the sale of the Naval Petroleum Reserves (NPR), I would provide an additional \$477 million to bring the fill rate up to 100,000 barrels per day, and an additional \$208 million to establish a separate 10 million barrel defense petroleum inventory to offset the disposition of the NPR.
- To improve the speed and accuracy of tax processing and expand information services provided to taxpayers, I would provide a \$241 million increase for the Internal Revenue Service. These funds are designed to assure smooth implementation of the 1986 tax reforms.

Maintaining peace in a troubled world is the most important responsibility of government. Fortunately, during the past 7 years, our defense capabilities have been restored toward levels more consistent with meeting our responsibility to provide an environment safe and secure from aggression. Specifically, combat readiness has been improved, and our forces have been modernized.

The proposals for national security contained in this budget represent an essential minimum program for keeping America safe and honoring our commitments to our friends and allies. Anything less would jeopardize not only our security—and that of our friends and allies—but also would dim the prospects for further negotiated agreements with our adversaries.

As called for in the Bipartisan Budget Agreement, my budget requests defense funding of \$299.5 billion in budget authority and \$294.0 billion in outlays for 1989. It also provides for about 2 percent real growth in these programs in future years. Also, as called for in the Agreement, my budget requests \$18.1 billion in budget authority for discretionary spending for international affairs. This includes \$8.3 billion in security assistance to allied and friendly countries where the United States has special security concerns.

NEEDED PROGRAMMATIC REFORMS

Incentives.—It is essential to continue to change the incentive structure for many domestic Federal programs to promote greater efficiency and cost-effectiveness. This budget proposes to create such needed incentives.

Many Federal programs offer payments without sufficient regard for how well taxpayers' money is being spent. For example, farm price support programs, under the Food Security Act of 1985, are much too costly. I plan to continue pushing for the elimination of artificially high price supports, thereby reducing the need for export subsidies. In particular, I plan to propose amendments to the Act to modify the counterproductive sugar price support program that currently poses significant problems in the areas of trade policy, foreign policy, and agricultural policy. The importance of agricultural trade to the economic health of the farm sector and the Nation as a whole mandates increased reliance on free markets, not government largesse.

The budget proposes certain reforms in the medicare program in order to achieve the savings agreed to in the Bipartisan Budget Agreement. First, as justified by the results of several independent studies, I propose to reduce the add-on payment for teaching hospitals under the prospective payment system (PPS) for indirect medical education from 7.70 percent to 4.05 percent, the best estimate of the added costs incurred historically by teaching hospitals. Second, I propose to limit medicare overhead payments for graduate medical education and make consistent varying secondary payor enforcement mechanisms. To reduce escalating supplementary medical insurance costs and help slow future increases in beneficiary premiums, I propose to limit payments for certain overpriced physician procedures, limit payments for durable medical equipment and supplies, and eliminate a loophole in the payment process for kidney dialysis. In total, these reforms would reduce spending for medicare by \$1.2 billion from the level that would occur if current law were continued. Spending for the medicare program would still increase by 7 percent from 1988 to 1989.

Although the provision of needed legal services for those who cannot afford them is an important goal in our society, the current system earmarks a large portion of the funding to "National and State Support Centers" that have been criticized for political involvement. I urge Congress to disallow use of Federal funds for such "think tanks" and limit the use of funds to the *direct* assistance of the poor in need of legal aid.

The Government often continues programs at the Federal level that are no longer needed. This is the case with rural housing programs, the Economic Development Administration, urban mass transit discretionary grants, urban development action grants,

sewage treatment, Small Business Administration direct loans, housing development action grants, the housing rehabilitation loan program, and economic development programs of the Tennessee Valley Authority. Efforts to reverse this situation have been undertaken by prior administrations as well as my own, but the limited results to date indicate the difficulty of curbing excessive government involvement in these areas.

Regulatory Relief.—For 7 years I have worked to reduce the excess burdens of government regulation for all Americans—working men and women, consumers, businesses, and State and local governments. As a result, various departments and agencies have reduced the scope and costs of Federal regulation. Federal approval of experimental drugs has been expedited, making them available to treat serious or life-threatening diseases when other treatments do not work. Excessive burdens on State and local governments are being lifted. Access to goods and services has been made easier, and at less cost. Federal reporting requirements on individuals and businesses have been eased, as well as the paperwork burden on those who wish to compete for contracts with the Federal Government. Under the leadership of the Presidential Task Force on Regulatory Relief, headed by the Vice President, the Administration will continue these and other efforts to lessen the burden of excessive government regulation.

As a case in point, my budget proposes termination of the Interstate Commerce Commission, contingent upon enactment of legislation that completes deregulation of the motor carrier industry. There is no justification for continued economic (as opposed to safety) regulation of surface transportation, and there is a substantial argument against it. As a result of economic deregulation of trucking and railroads, consumers save tens of billions of dollars each year, and the industry is healthier, more innovative, and better able to adapt to changing economic circumstances. This is no time to turn back the clock.

Privatization.—The government and the private sector should do what each does best. The Federal Government should not be involved in providing goods and services where private enterprise can do the jobs cheaper and/or better. In some cases, the fact that no private provider exists is a reflection of government policy to prohibit competition—as with first class mail service. In other cases, an absence of private providers reflects a government policy of providing large subsidies—as with uranium enrichment. Invariably, the taxpayer ends up paying more for less.

Accordingly, my budget proposes that a number of Federal enterprises be transferred back to the private sector, through public offerings or outright sales. Following our successful sale of Conrail

and auctioning of \$5 billion in selected loan portfolios, I am proposing the sale not only of the Naval Petroleum Reserves, but also of the Alaska Power Administration, the Federal Government's helium program, excess real property, and a further \$12 billion in loan portfolios. In addition, I have proposed legislation to authorize a study of possible divestiture of the Southeastern Power Administration, and plan to study possible privatization of our uranium enrichment facilities, as well as ways of making the U.S. Postal Service more efficient through greater reliance on the private sector. Such "privatization" efforts continue to be a high priority of this Administration, and I look forward to acting on the final recommendations of the Privatization Commission, which I established last September.

Privatization does not necessarily imply abrogation of government responsibility for these services. Rather, it recognizes that what matters is the service provided, not who provides it. Government has an inherent tendency to become too big, unwieldy, and inefficient; and to enter into unfair competition with the private sector.

The Federal Government should also depend more on the private sector to provide ancillary and support services for activities that remain in Federal hands. Therefore, I am proposing the development of a private mediating institution to reduce the backlog of cases before the U.S. Tax Court. I propose that the private sector be relied upon for booking functions for concessional food programs. I also encourage the complete privatization of wastewater treatment plants, certain mass transit projects, the Department of Agriculture's National Finance Center, and the Rural Telephone Bank.

In addition, our Administration plans to initiate privatization and commercialization efforts involving Federal prison industries, relying on a private space facility for micro-gravity research opportunities in the early 1990's, commercial cargo inspection, military commissaries, Coast Guard buoy maintenance, and the management of undeveloped Federal land. Moreover, my budget proposes that the work associated with certain Federal employment positions be reviewed for the feasibility of contracting their responsibilities out to the private sector as yet another way to increase productivity, reduce costs, and improve services.

One of the best ways to test the worth of a governmental program or a particular project is to shift some of the cost of that program or project to the direct beneficiaries. We have done that, for example, with water resources development projects. As a result, local sponsors and users choose to proceed only on the projects that are most important and most cost effective.

Management Improvements.—As we all know, the Federal Government has a major effect upon our daily lives through the direct delivery of services, the payment of financial assistance through various entitlement programs, the collection of taxes and fees, and the regulation of commercial enterprises. As the 21st century approaches, the Federal Government must adapt its role in our society to meet changing demands arising from changing needs and requirements. At the turn of the century, the U.S. population will exceed 268 million, with a greater proportion of elderly requiring more specialized services. The Nation will operate at a much faster pace as changes in technology and communication link the world's economies, trade, capital flows, and travel as never before.

I have asked the Office of Domestic Affairs and the Office of Management and Budget to work with the President's Council on Management Improvement to conduct an in-depth review and recommend to me by this August what further adjustments in the Federal role should be made to prepare for the challenge of government in the 21st century. This summer I will receive their report, "Government of the Future." I also intend to complete the "Reform '88" management improvement program I started 6 years ago to overhaul the administrative, financial, and credit systems in our Federal Government; to implement productivity and quality plans in each agency; and to examine the needs of the Federal work force of the future. I want to leave a legacy of good management of today's programs, with plans in place to handle tomorrow's challenges.

Efforts to improve the management of the Federal Government must be continued. We have all heard stories of the horrible waste that occurs in the Federal Government. Some of it is obvious—like the billions of dollars in unneeded projects that were included in the thousand-page 1988 spending bill that was dropped on my desk last December. Some are not obvious—like the billion dollars in unnecessary interest expense the government paid, year after year, because it lacked a cash management system, or the billions of dollars lost annually for lack of a credit management process to ensure collection of the trillion dollars in loans owed the Federal Government.

In July 1980, I promised the American people: "I will not accept the excuse that the Federal Government has grown . . . beyond the control of any President, Administration or Congress . . . we are going to put an end to the notion that the American taxpayer exists to fund the Federal Government. The Federal Government exists to serve the American people . . . I pledge my Administration will do that." I have delivered on that promise.

The first step was taken within months after my inauguration when I formed the President's Council on Integrity and Efficiency,

composed of the agency Inspectors General. By the time I leave office, they will have delivered savings of over \$110 billion in reduced waste, fraud, and abuse to the American people.

Then, in March 1982, I initiated the world's largest management improvement program with these words: "With Reform '88 we're going to streamline and reorganize the processes that control the money, information, personnel and property of the Federal bureaucracy." I told my Cabinet at that time that "we have six years to change what it took twenty or thirty to create—and we came to Washington to make changes!" I have followed up on that commitment. The President's Council on Management Improvement has overseen this effort, and is generating significant results.

These efforts are described in greater detail in my *Management Report*, which is being submitted concurrently. They can succeed only if all Federal managers and employees work together. Therefore, I propose in this budget a new approach to paying Federal employees who increase their productivity. I ask the Congress to modify the current system of virtually automatic "within-grade" pay increases for the roughly 40 percent of employees eligible each year to one that is based on employee performance. This will give Federal employees stronger incentives to improve service delivery and reduce costs to the taxpayer.

THE BUDGET PROCESS

As I have stressed on numerous occasions, the current budget process is clearly unworkable and desperately needs a drastic overhaul. Last year, as in the year before, the Congress did not complete action on a budget until well past the beginning of the fiscal year. The Congress missed every deadline it had set for itself just 9 months earlier. In the end, the Congress passed a year-long, 1,057-page omnibus \$605 billion appropriations bill with an accompanying conference report of 1,053 pages and a reconciliation bill 1,186 pages long. Members of Congress had only 3 hours to consider all three items. Congress should not pass another massive continuing resolution—and as I said in the State of the Union address, if they do I will not sign it.

I am asking for a constitutional amendment that mandates a balanced budget and forces the Federal Government to live within its means. A constitutional amendment to balance the Federal budget—and a provision requiring a super-majority vote in the Congress to increase taxes—would impose some much-needed discipline on the congressional budget process. Ninety-nine percent of Americans live in States that require a balanced State budget, and a total of 32 States already have passed resolutions calling for a convention for the purpose of proposing a balanced budget amendment to the U.S. Constitution.

Also, I am asking the Congress for a line-item veto, so that my successors could reach into massive appropriation bills such as the last one, cut out the waste, and enforce budget discipline. Forty-three State Governors have a line-item veto; the President should have this power as well. As Governor of the State of California (1967-1975), I used the line-item veto 943 times. The California State legislature upheld each of these vetos, even though both Houses were controlled by the opposition party.

In addition, I propose the following further reforms to the budget process:

- (1) *Joint budget resolution.* The budget process has so degenerated in recent years that the presidential budget is routinely discarded and the congressional budget resolution is regularly disregarded. As a remedy, I propose that henceforth the Congress and the Executive collaborate on a joint resolution that sets out spending priorities within the receipts available. The requirement of a Presidential signature would force both branches of government to resolve policy differences before appropriations measures must be formulated. The budget process could be further improved by including in the budget law allocations by committee as well as by budget function.
- (2) *Individual transmittal of appropriation bills.* The current practice of transmitting full-year continuing resolutions skirts appropriations committee-subcommittee jurisdictions. More importantly, it does not permit the Legislative and Executive branches to exercise proper scrutiny of Federal spending. Therefore, I propose a requirement that appropriations bills be transmitted individually to the President.
- (3) *Strict observance of allocations.* During the 1980s, an unacceptable budget practice evolved within the Congress of disregarding congressionally approved function allocations. Funds regularly were shifted from defense or international affairs to domestic spending. I strongly urge that each fiscal year separate national security and domestic allocations be made and enforced through a point of order provision in the Budget Act.
- (4) *Enhanced rescission authority.* Under current law, the President may propose rescissions of budget authority, but both Houses of Congress must act "favorably" for the rescission to take effect. In 1987, not a single rescission was enacted, or even voted on, before expiration of the 45-day deadline. I propose a change of law that would require the Congress to vote "up or down" on any presidentially proposed rescission, thereby preventing the Congress from ducking the issue by simply ignoring the proposed rescission and avoiding a recorded vote.
- (5) *Biennial budgeting.* The current budget process consumes too much time and energy. A 2-year budget cycle offers several

advantages—among them, a reduction in repetitive annual budget tasks, more time for consideration of key spending decisions in reconciliation, and less scope for gimmicks such as shifting spending from one year to the next. I call on the Congress to adopt biennial budgeting.

- (6) *Truth in Federal spending.*—As part of my Economic Bill of Rights, I will shortly transmit legislation that will require any future legislation creating new Federal programs to be deficit-neutral. In addition to requiring the concurrent enactment of equal amounts of program reductions or revenue increases, my proposal would require that all future legislation and regulations be accompanied by financial impact statements, including the effect on State and local governments.

Adoption of these reforms should enable the Federal Government to make informed decisions in a deliberate fashion that fosters rational priorities. The American people deserve no less from their elected representatives.

CONCLUSION

Looking back over the past 7 years we can feel a sense of pride in our accomplishments. Important tasks remain, however. The large and stubbornly persistent budget deficit has been a major source of frustration. It threatens our prosperity and our hopes for lessening the burden on future generations.

Two years ago, the Legislative and Executive branches of government responded to this threat by enacting the G-R-H Act, which mandated gradual, orderly progress toward a balanced budget over the next several years. My budget achieves the 1989 target of the amended Act while preserving legitimate programs for the aged and needy, providing for adequate national security, devoting more resources to other high-priority activities, and doing so without raising taxes.

My budget also embodies the Bipartisan Budget Agreement reached last November. In presenting this budget, I am keeping my end of the bargain. I call upon the Congress to uphold its end—by ensuring that appropriations and other legislation are in full accord with the Agreement. By exercising this measure of restraint and self-discipline, we can secure great benefits for the Nation: a lower budget deficit, reduced demand on credit markets, more stable financial markets, a steadily declining trade deficit, and continued prosperity with non-inflationary growth. And, by reforming the budget process, the Congress can improve its decisionmaking and garner the thanks of a grateful public. Surely, these are small prices for what is at stake.

RONALD REAGAN

FEBRUARY 18, 1988