12/20/77 [2]

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Soc Sec

THE WHITE HOUSE
WASHINGTON

12-20-77

Concern

Flaw - indexing

Workers/beneficiaries 100:1 → 3:1 → 2:1

Recession/Depression in FP/Civil War

Financially sound 1980 → 2030

=

Eliminates sex discrimination

Eases earnings test

Pact - Workers - employers - security

THE PRESIDENT HAS SEEN.

C

Cambridge Survey Research

Suite 1250 1775 Pennsylvania Avenue, Washington, D.C. 20006 Telephone (202) 223-6345

December 20, 1977

MEMORANDUM

TO HAMILTON JORDAN

FROM PAT CADDELL

RE PANAMA QUESTIONS

Recent surveys indicate some increase in support for the Panama Canal treaties over the last few months. The figures, from several different surveys, also indicate that the wording of the questions -- and the amount of information they convey about the treaties -- is of crucial importance in the amount of support that is seen.

As the first table shows -- using a relatively long explanatory wording -- there has been a six point increase in support since late September and an overall 14 point change in margin.

The United States government has recently concluded a treaty with the government of Panama to return the Panama Canal, and the Canal Zone to Panama over time finishing by the year 2000. The U.S. would retain rights to defend the Canal and Panama agrees to maintain its neutrality and keep it open.

December 1977	36%	18	47	+14
September 1977	30%	15	55	

IN CAMBRIDGE
10 Moulton Street

Looking at where the changes come, we see that there have been fairly uniform gains in support among Democrats, Republicans, and Independents. A plurality of those who rate President Carter favorably now back the treaties, while in September even Carter backers failed to rally to the treaty.

Regionally, support has increased in most areas, though it has fallen off in the Pacific area. The Northeastern region is the strongest in support of the treaties and the only one giving it plurality support. Support is also up substantially in both the Midlands and South. (The South is now 35% in favor, 44% opposed.)

In a follow-up question in the December survey, we suggested the idea that the U.S. would have a permanent right to defend the Canal and this idea actually produced a plurality in favor of the treaty.

Let's say the Panama Canal treaty contained a clause which allowed the United States to defend the Canal forever: would you then favor or oppose the treaty?

Favor	49%	50
Don't know	21	
Oppose	30	30

It seems clear that if treaty supporters can convey the idea that this right to defend the canal is, indeed, part of the treaty we already have, they will be able to win public support for the treaties.

However, the problem is clearly one of information. Most people remain uninformed about the treaties. Another national survey we conducted in early December asked respondents to react purely to the treaties without giving them any information. As the next table shows, opposition was much stronger.

As you may know, the U.S. Senate is currently considering whether to approve or disapprove of the Panama Canal treaty, whereby the U.S. would turn over the Panama Canal to the government of Panama by the year 2000. From what you know right now, would you favor or oppose passage of that treaty?

Favor	26%
Don't know	21
Oppose	53

All of this suggest that opinion is extremely fluid. The public does not have hard and fast ideas on the Canal Treaties; they do not have information. Giving them more information (and particularly giving them the idea that the Canal can still be defended) increases support for the treaties. Most people always argue that those who oppose them do so from ignorance; in this case it just happens to be true. Giving the people knowledge about the treaties has to be a high priority item.

THE PRESIDENT HAS SEEN.

2:00 PM

C

THE WHITE HOUSE

WASHINGTON

December 19, 1977

MEMORANDUM FOR THE PRESIDENT

FROM: Jack Watson Jack

SUBJECT: MEETING WITH CECIL ANDRUS,
Tuesday, December 20, 1977,
at 2:00 p.m. (20); Oval Office

Basically, Cecil wants to get your general guidance on three subjects:

(1) Following up on your decisions in the budget review, Cece needs some clarification as to how you want him to proceed with the water projects. Specifically, he needs to know whether or not you want to seek deauthorization on the projects that we lost (i.e., those projects on which our position was not sustained). Cece believes that we should simply not fund the projects rather than ask for specific deauthorization for them. In his opinion, seeking deauthorization would cause an unnecessary aggravation of the situation. I believe that the Domestic Policy Staff and OMB agree with Cece on this strategy, and that a memorandum on the subject from Stu and Jim will be forthcoming to you shortly.

(2) Cece would like to know what general timeframe and priority you have in mind for the Natural Resources reorganization. Accordingly to Cece, there is beginning to be a great deal of discussion about whether the Forestry Service and NOAA will be moved to Interior, and I think Cece simply wants to get some general sense of your present thinking on the subject. The OMB reorganization proposal on Natural Resources is not due until April 1st.

(3) Cece wants to know to what extent you want to be involved in the decision-making process on federal excess lands. As you know, that subject does ~~not~~ have a high Presidential priority in the 1978 agenda ~~in~~ terms of your own personal involvement.

THE PRESIDENT HAS SEEN

5:00 PM

THE WHITE HOUSE

WASHINGTON

December 20, 1977

MEMORANDUM FOR: THE PRESIDENT

FROM: STU EIZENSTAT Stu
JOE ONEK
BOB HAVELY

SUBJECT: Meeting with Senator Kennedy on National Health Insurance

<u>Background for your meeting with Senator Kennedy:</u>

1. As you know, there is wide disagreement on what the substance of a National Health Insurance plan should be; the principle area of debate is the extent to which federal financing and federal administration are required to reform the health care delivery system.

2. Organized labor continues to support, with only minor modifications, full federal financing and administration of NHI -- as contained in S.3, the Health Security (Kennedy-Corman) bill. The Kennedy-Corman approach will be strongly opposed by business and insurers, as well as by health care providers, and is incompatible with the Congress's current antipathy toward "big-spending, big-government" programs. On the other hand, it is probably true that no NHI proposal can pass without the support of organized labor. Most other interest groups, although they may have introduced NHI proposals, are content with the status quo and will not aggressively pursue any NHI legislation.

3. It will be very difficult to persuade organized labor to modify its position. When Senator Kennedy joined forces with Wilbur Mills to introduce a NHI bill which provided for substantial copayments and a major administrative role for private insurance companies, he was strongly denounced by organized labor. Although it is a desirable goal, it is uncertain whether Senator Kennedy could or would help us gain labor approval for a bill which could pass.

4. You have refused to endorse the Kennedy-Corman bill. However, several of the NHI criteria you advanced in the National Student Medical Association speech are interpreted as an endorsement of key Health Security principles. The most prominent of these is your statement that "benefits should be insured by a combination of resources: employer and employee shared payroll taxes and general tax revenues," which to some appears to rule out a mandated private health insurance approach.

5. The UAW recognizes that Kennedy-Corman cannot pass. Nevertheless, for internal reasons, the union leadership wants you to introduce the strongest bill possible, and has threatened to make this issue the key to its future relationship with the Administration. You could gain its approval by introducing a Kennedy-Corman type bill, but you would then be branded with the big-spender, big-government label.

6. Congress cannot spend much time on NHI next session. Nevertheless, the UAW wants the bill introduced quickly, to maintain momentum and to force Congressional candidates to take a stand on the issue in the 1978 election. Senator Kennedy urges a similar course, so that his committee can hold hearings while Senate Finance works on other issues.

Many members of Congress have urged that introduction of NHI legislation be delayed until after the election. They do not wish to take a position on controversial legislation for which they are unprepared. Of course, the leadership has repeatedly expressed its concern about the introduction of major legislation which the Congress cannot possibly act upon.

<u>Suggested talking points for your meeting with Senator Kennedy:</u>

1. My staff and HEW are working full time to develop NHI options. While it took HEW longer to prepare for NHI development than we would have liked, there has been and there will be no deliberate slowdown in the pace of this development work.

2. I face, however, the following problems:

a. there is wide disagreement on the merits within and without the Administration;

b. the bill that labor supports cannot pass, and labor can probably stop any other bill from passing; and

c. there is pressure from the leadership and many members of Congress for the Administration to delay introduction of our NHI bill until the Congress and I are genuinely prepared to spend the substantial amounts of time required to enact such a bill.

3. I would like to ask you to undertake a crucial role in the NHI development process, by exploring with labor leaders any changes in their positions they would be willing to entertain, in order to develop a bill with a good chance of passage.

I would like to talk again when I return from my trip, and at that point we will be better able to make an informed decision on the proper timing for the introduction of the Administration's NHI proposal.

4. I would like to ask if you frankly feel the increase in payroll taxes necessary to pay for NHI are palatable after the Social Security tax rise.

THE WHITE HOUSE
WASHINGTON

December 20, 1977

Bob Lipshutz

The attached was returned in the President's outbox today and is forwarded to you for your information. The signed original has been given to Bob Linder for appropriate handling.

Rick Hutcheson

cc: Bob Linder

JEFF CARTER'S SECRET SERVICE PROTECTION

THE WHITE HOUSE
WASHINGTON

	FOR STAFFING
	FOR INFORMATION
/	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND

to Blumenthal

ACTION	FYI	
		MONDALE
		COSTANZA
		EIZENSTAT
		JORDAN
	/	LIPSHUTZ
		MOORE
		POWELL
		WATSON
		LANCE
		SCHULTZE

	ENROLLED BILL
	AGENCY REPORT
	CAB DECISION
	EXECUTIVE ORDER

Comments due to Carp/Huron within 48 hours; due to Staff Secretary next day

		ARAGON
		BOURNE
		BRZEZINSKI
		BUTLER
		CARP
		H. CARTER
		CLOUGH
		FALLOWS
		FIRST LADY
		HARDEN
		HUTCHESON
		JAGODA
		KING

		KRAFT
		LINDER
		MITCHELL
		MOE
		PETERSON
		PETTIGREW
		POSTON
		PRESS
		SCHLESINGER
		SCHNEIDERS
		STRAUSS
		VOORDE
		WARREN

THE WHITE HOUSE

WASHINGTON

December 20, 1977

MEMORANDUM FOR

THE SECRETARY OF THE TREASURY

As you are aware, my son, Donnel Jeffrey Carter, is currently being protected by the U.S. Secret Service pursuant to the provisions of Section 3056 of Title 18, U.S. Code, authorizing the protection of members of the immediate family of The President.

I hereby decline Secret Service protection for Jeffrey Carter during the period of December 21, 1977, through January 3, 1978. Protection should cease for Jeffrey at 0900 on December 21, 1977, in Washington, D.C. Protection for Jeffrey should resume on January 3, 1978, 1200, at 3973 Wedgefield Circle, Decatur, Georgia.

In making this decision, I relieve the U.S. Secret Service of any and all responsibility for Jeffrey's physical security during the aforementioned period of time.

Jimmy Carter

THE WHITE HOUSE
WASHINGTON

December 20, 1977

Secretary Blumenthal
Stu Eizenstat
Jim McIntyre

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling.

Rick Hutcheson

RE: MEETING ON THE 1978 TAX AND ECONOMIC PROGRAM

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS

Date: 12/20/77

To: Bill Simon

From: ~~CHARLES L. SCHULTZE~~ Teri

Attached is the original of the Tax memo, which the President handed to Charlie this a.m.

Charles
J

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

December 18, 1977

MEMORANDUM FOR THE PRESIDENT

FROM: W. Michael Blumenthal
Stu Eizenstat
James McIntyre
Charlie Schultze

Subject: Monday's Meeting on the 1978 Tax and Economic Program.

Attached are the following papers for your economic meeting tomorrow:

1. <u>A memo from CEA which discusses:</u>

   A. The economic and budgetary consequences of alternative tax policies.

   B. When to make the tax cuts effective, and the problem of a Third Concurrent Budget Resolution

   C. The elements of an anti-inflation program.

2. <u>A Treasury memo which discusses:</u>

   A. Two alternative tax reductions and reform packages.

   B. The remaining areas of disagreement about the reform elements of the tax package.

3. <u>A memo on employment programs</u>

   Stu Eizenstat has prepared a memorandum on the various employment programs included in the 1979 budget.

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

December 18, 1977

MEMORANDUM FOR THE PRESIDENT

From: Charlie Schultze CLS

Subject: The Economic and Budgetary Consequences of Alternative Fiscal Policies

Economic Setting

A year ago we set forth several economic goals for 1977. We have not fully met the goals we set forth, but the shortfall has not been large:

- We projected GNP growth between 5-3/4 and 6 percent from fourth quarter 1976 to fourth quarter 1977; the actual growth is likely to fall just at the low end of that range.

- We projected unemployment to decline to 6.6 percent by year-end, from 7.8 percent in December 1976; in November, the rate was 6.9 percent; the shortfall from our goal was due to a surprisingly large growth in the labor force.

The economy is emerging from its mid-summer and early fall doldrums.

- GNP grew by about 5 percent in the third quarter.

- It is likely to grow by only 4 percent in the fourth quarter, but this reduction is due largely to reduced inventory accumulation; final sales in the fourth quarter are growing quite rapidly, led by consumer spending.

- Economic growth in the early months of 1978 is likely to be quite good, as business firms move to bring their inventories into better balance with growing sales.

<u>Outlook for 1978</u>

There is strong reason to believe that, in the absence of vigorous fiscal action, the growth of GNP would slow progressively during 1978 and 1979, after a good start early in the year. There are several reasons behind this outlook:

1. The table below shows the increases in effective tax burdens facing individual taxpayers in the next several years on account of social security, unemployment compensation, and the impact of inflation and growth on average personal tax rates.

	(billions of dollars)			
	1978	1979	1980	1981
Social security and unemployment insurance	8	16	19	36
Effect of inflation and growth	6	16	31	46
Total	14	32	50	82

These increased taxes will exert a steadily growing drag on the economy.

2. After mid-year 1978 the expansive effects of our 1977 economic stimulus package -- which has been helping to offset the drag -- will level off.

3. The balance of trade deficit may deepen somewhat further; recoveries abroad are not likely to pick up in time to add strength to our exports, and imports will increase further.

4. Business fixed investment, on the basis of current evidence, will not show enough strength to offset these other factors.

In the absence of a sizable tax cut for business and individuals, we would expect the growth of GNP to slow to about 3-1/2 to 4 percent in the last half of 1978 and to decline further to around 3 to 3-1/4 percent in 1979. The unemployment rate would fall to perhaps 6-1/2 percent by mid-1978 and then rise gradually.

Very large tax reductions for individuals will be needed between now and 1981 to offset at least part of the tax increases shown in the table above if we are to keep the economy from stalling under the weight of fiscal drag. On the assumption that you do not wish to go to Congress for another tax reduction in 1979, then the one in 1978 has to be large enough to carry the economy through all of 1979, and well into 1980, when another tax reduction might reasonably be enacted.

Alternative tax packages: economic and budgetary consequences

In view of the large increases in social security and unemployment insurance taxes, the rising effective tax rates from inflation, and the need for business tax cuts to stimulate capital formation, all of your economic advisers recommend a tax reduction larger than the $20 billion contained in the November 23 Treasury tax memorandum to you.

In the attached paper, the Treasury lays out the components of two alternative tax packages:

Package 1: A $25 billion cut (evaluated at calendar 1979 income levels):

. Individual cuts	$15 billion
. Business cuts	$ 7 billion
. Excise and payroll tax cuts	$ 3 billion

The excise and payroll tax cuts were chosen as moves which are desirable in themselves, but would also make a small contribution to the reduction of inflation. They consist of:

- eliminating immediately the Federal telephone excise tax (now scheduled to phase out by 1983) — $1.5 billion — ok
- reducing airline ticket tax from 8 percent to 2 percent — $0.8 billion — ~~to~~ 70

- reducing the Federal unemployment insurance tax from 0.7 to 0.5 percent (which requires general revenue contributions to the Federal unemployment insurance trust fund) $0.8 billion

Package 2: A $30 billion cut; this is the same as package 1, except that an additional $5 billion is added to the individual income tax cut. The components of this package are:

. Individual cuts	$20 billion
. Business cuts	$ 7 billion
. Excise and payroll tax cuts	$ 3 billion

In all cases the tax cuts were assumed to take effect on October 1, 1978. The effective date of the tax reduction is a policy issue, and is discussed later in this memorandum. The budget outlays used in the forecasts are shown below.

	FY 1978	FY 1979	FY 1980	FY 1981
Outlays (billions)	$457	$501	$541	$584

The other assumptions that were made in these assessments are listed in the appendix.

Economic and budgetary results, 1978 and 1979

The economic and budgetary consequences of these two alternatives are shown, for comparative purposes, relative to a base case. The base case assumes the tax cuts included in the November 23 Treasury tax reform memo, which amount to $20 billion in calendar 1979; $16 billion for individual income tax cuts and $4 billion for business.

The performance of the economy in 1978 and 1979 with the alternative tax options is shown in Table 1. Since the reduction in taxes is assumed to occur in October, the size of the tax cut would have only a relatively small effect on economic performance in 1978. Taking 1978 and 1979 together, however, the differences are substantial.

Table 1
Forecast with Alternative Fiscal 1979
Tax Packages

	Calendar Years			
	1978	1979	1980	1981
ECONOMIC RESULTS:				
Real GNP Increases, Percent, Q_4/Q_4				
20 A. Base	4.4	4.4	4.3	2.3
25 B. Package 1	4.6	4.7	4.3	2.3
30 C. Package 2	4.7	4.9	4.4	2.9
Unemployment Rate, Percent, Q_4				
A.	6.5	6.2	5.8	6.0
B.	6.4	6.0	5.5	5.7
C.	6.4	5.9	5.4	5.5
Inflation Rate, Percent, Q_4/Q_4				
A.	6.3	6.3	6.5	6.1
B.	6.3	6.3	6.7	6.2
C.	6.3	6.4	6.7	6.3
	Fiscal Years			
	1978	1979	1980	1981
UNIFIED BUDGET RESULTS (Billions of Dollars)				
Deficit				
A.	-56	-58	-34	-6
B.	-56	-61	-36	-8
C.	-56	-65	-39	-20 1/

1/ Without an additional $20 billion tax cut in 1980, the 1981 deficit would be $11 billion.

With the base case, $20 billion, tax reduction, real GNP growth during the two years would average a little under 4-1/2 percent, and the unemployment rate would still be at about 6-1/4 percent by the fourth quarter of 1979.

With the Package 1, $25 billion tax reduction, real GNP growth would be higher, but the unemployment rate would remain above 6 percent until the end of 1979, when it would just reach the 6 percent level.

With Package 2, a $30 billion tax reduction, real GNP growth over the two years would average between 4-3/4 and 5 percent, and the unemployment rate would be a shade under 6 percent by the fourth quarter of 1979. The impact on inflation of stronger economic performance over the two years would be comparatively small.

The impact of the three options on the 1979 budget deficit is shown in the bottom section of Table 2. The tax cut in Package 1 would lead to a unified budget deficit in fiscal 1979 of about $61 billion; the larger tax reduction would produce a deficit of about $65 billion.

Extension of the Forecasts to 1980

Forecasting beyond a year or two is an extremely hazardous exercise. At best, we can see general tendencies developing over a longer horizon. The results of extending the forecast beyond 1979 should be so interpreted.

By late 1979 GNP would be about 0.8 percent higher in the largest tax cut option compared to the base case. In 1980, the rate of growth would not be much different as among the two tax packages, so that the differences in unemployment prevailing at the end of 1979 would persist. With the base case tax cut, unemployment would have fallen to a little below 6 percent by mid-1980; with the larger $30 billion tax cut it would be in the neighborhood of 5-1/2 percent.

The rate of inflation may increase somewhat further in 1980 to a range of 6-1/2 to 7 percent. By that time, the rate of capacity utilization would be up to a range of 88 to 90 percent.

In all three cases, the budget deficit would decline in FY 1980, ranging from $34 billion with the base case tax cut to $39 billion with Package 2.

Extensions to 1981

We have extended the forecast to 1981 to illustrate the connection between economic performance and budgetary policy over the longer term. To do this, we assumed:

1. No further tax cuts in the base case and Package 1 options;

2. Another $20 billion tax cut, effective January 1, 1981, in the Package 2 case.

Enacting the small base case tax cut in 1979, and refusing to accept further tax cuts in 1981, would produce an approximate balanced budget in 1981 (actually a $6 billion deficit). But unemployment would be 6 percent by year-end and rising. (This scenario is shown in the base case in Table 1.)

At the other end of the range, enacting the larger Package 2 tax cut in 1979, following up with a $20 billion cut in 1981, would produce a substantial shrinkage in the budget deficit between 1979 and 1981, but the deficit would still amount to $20 billion in the latter year. Unemployment, on the other hand, would have fallen to about 5.4 percent in late 1980 and would remain close to that level in 1981.

Economic growth would be likely to slow substantially in 1981, even with additional 1981 tax cuts incorporated into the Package 2 case. Social security taxes are scheduled to rise by $16 billion at the beginning of 1981, and the cumulating effects of fiscal drag would also be taking their toll by that time.

This extension of the forecast to 1981 highlights several facts relevant to decisions on the 1979 budget.

- The larger fiscal 1979 tax reduction included in this exercise will leave us short of our 1981 goal of a 4-3/4 percent unemployment rate, even with an additional $20 billion in tax reductions in 1981.

- The base case tax package yields a budget that is almost in balance in fiscal 1981, assuming no further tax cuts. But we would be much further below our economic goals in 1981, with the unemployment rate still around 6 percent.

- The $20 billion actual budget deficit in fiscal 1981, which accompanies the more expansionary fiscal policy, corresponds generally with results of earlier forecasts presented to you in July and October, which indicated that a strategy along these lines would yield an unemployment rate of around 5-1/4 percent in 1981 and an actual budget deficit of around $20 billion.

- The projected rise in the capacity utilization rate to a range of 88 to 90 percent by 1980 is disturbing. Such a rate of capacity use <u>could</u> trigger greater price pressures than we have allowed for, although ample capacity abroad may serve as an ameliorating factor. It is clearly important, therefore, to encourage a substantial rise of business fixed investment.

<u>Risks in the Forecast</u>

What you decide in the way of tax reduction will depend importantly on how much credence is put in the forecast, and especially on an evaluation of the risks in it. The outlook for the private economy in 1978 is broadly in line with what other private forecasters anticipate. That is some comfort. The risks in the forecast, however, seem to lie principally on the side of a somewhat weaker economy than we are forecasting, for several reasons.

First, our assumptions about <u>monetary policy</u> are optimistic, both in the near term and over the longer run. Keeping Treasury bill rates from rising above 7 percent (with our more expansive tax package) will require both good luck on the price side and an extremely cooperative Federal Reserve.

Growth rates of the monetary aggregates will probably have to be above the upper ends of the Federal Reserve's current target ranges -- much above in the case of M_1 -- to achieve the rates of economic expansion we are forecasting.

Second, our assumptions about the foreign sector are also comparatively sanguine for the near term. The deficit in our foreign trade accounts may deepen more than we have allowed for in 1978 and 1979 unless additional stimulative actions are taken abroad.

Third, the forecast assumes no unfavorable surprises -- for example, a sharp runup of food prices, a deterioration of business confidence, or a marked increase in the personal saving rate -- that could lead to a substantial weakening of growth.

MAJOR DECISION POINTS

1. The size of the tax reductions

None of your economic advisers believe that the base case, a $20 billion tax reduction, is sufficient. It would offset less than two-thirds of the rising tax rates due to increased payroll taxes and fiscal drag. Many taxpayers in the $20,000 to $30,000 income class could end up with tax reductions less than the social security tax increases they are now facing. The $4 billion in business tax reductions is too small to have the desired effect on investment. By mid-1980, the unemployment rate would still be hovering around the 6 percent range. We would have given a clear signal that we are not committed to the economic goals we set out earlier.

The Vice President, Secretaries Blumenthal and Kreps, Under Secretary Cooper, Stu Eizenstat, and Charlie Schultze recommend Package 2, the $30 billion reduction. They believe a package of this size is needed to offset other tax increases, to put the economy on a path of steady growth, and to make sufficient inroads into the unemployment rate.

OMB Director McIntyre prefers Package 1, the $25 billion cut, on grounds that the larger package produces an unacceptably high deficit level for FY 1979, and does not generate enough of a difference in unemployment rates to make the larger deficit worthwhile.

Secretary Marshall recommends an additional $5 billion of spending on top of the largest tax reduction to keep your original employment target in reach. He points out that if this additional spending were temporary -- for example, by having a $5 billion public works program that was completed in 1980 -- then the 1981 deficit would actually be reduced. The feasibility of completing such a program by the end of 1980 is, of course, open to question.

If you decide to stay within the bounds of a $30 billion package, Secretary Marshall suggests substituting $2 billion of additional spending on public works or jobs programs for $2 billion of the tax reduction. He notes that this would have a slightly larger overall stimulative effect, and would be targeted more precisely to areas and groups with high unemployment.

2. The $501 billion budget

The $501 billion expenditure number for fiscal 1979 still represents an approximation, and final budget decisions have not been made. We assume that about $1 billion of the $501 billion represents a use of budget funds to make selected increases in programs designed to minimize Congressional and constituent problems.

The $501 billion breaks the "half-trillion" dollar expenditure level. Undoubtedly, there will be headlines about this. But most of your advisers do not believe it will create major problems. Moreover, publishing a budget total of $499.5 billion, or some other number just below $500 billion, may well lead to credibility problems.

3. The specific reform components of the tax package and the composition of the business tax reductions

There are still a few items about which your advisers are in disagreement. These are covered in the attached Treasury memorandum.

4. The effective date of the tax reductions and the problem of a Third Concurrent Budget Resolution

The economic and budgetary results of the alternative tax packages presented above assume that the tax reductions are made effective October 1, 1978, the beginning of the new fiscal year. An October 1 effective date would have the advantage of avoiding the need for a Third Concurrent Budget Resolution. If a Third Resolution were needed in any event, for an increase in budget authority, it would be desirable from the standpoint of economic performance in 1978 to accelerate the effective date of the individual income tax reductions to July 1, 1978.

The table below shows the results of such an acceleration for Package 2. Real GNP would grow faster in the latter half of 1978 with a mid-year tax cut, and the unemployment rate in the fourth quarter would be about one-tenth of a percentage point lower than with an October 1 effective date.

Effects of Accelerating the Effective Date of the Individual Income Tax Cuts in Package 2 from October 1, 1978 to July 1, 1978

	Half Year Ending:			
	2nd Qtr 1978	4th Qtr 1978	2nd Qtr 1979	4th Qtr 1979
Unemployment rate				
Cut effective Oct. 1	6.6	6.4	6.1	5.9
Cut effective July 1	6.6	6.3	6.1	5.9

little Δ

	Fiscal Years	
	1978	1979
Budget deficit (billions of dollars)		
Cut effective Oct. 1	-56	-65
Cut effective July 1	-60	-64

ANTI-INFLATION PROGRAM

In the CEA memo of December 7, and at the breakfast meeting with you on December 9, we covered the various options available to us on an anti-inflation program. Since then, we have examined the options further, and consulted on the Hill and with business and labor leaders.

1. Using tax cuts as a device for reducing inflation

We considered a program of grants to states, conditional on their cutting sales taxes. An $8.5 billion program would "buy" a 1 percent state sales tax reduction. In turn, this would provide a one-shot reduction in the consumer price index of perhaps 0.5 percent the first year and another 0.3 percent the second (as wage increases were affected). Among Congressional leaders we talked to (including Senator Ribicoff and Congressman Brooks whose committees would handle the bill), there was unanimous opposition to the idea. We have not included it among our proposals.

We also considered an "Okun" type proposal which would make a special tax reduction available to employees in firms which held wage and fringe increases below a stipulated amount. Both labor and business leaders expressed very strong opposition to this idea. We have not included it among our proposals.

We have included $3 billion of excise and payroll tax reductions which have the effect of lowering prices or costs. Each of the elements we believe makes sense in its own right. All together, they will have a small one-shot effect in lowering prices -- perhaps by 0.2 percent. We do not believe these cuts can be treated as the centerpiece of an anti-inflation program -- but they will help.

2. Business and labor cooperation in moderating private wage and price increases

We have met with a group of business leaders and, separately, with George Meany and Lane Kirkland. We believe, but are by no means yet sure, that we can work out the following approach.

A. In your State of the Union and Economic Messages, you would state the need for a deceleration of price and wage increases in 1978 and subsequent years.

B. The CEA in its Annual Report would project what the economy would look like with moderate deceleration of inflation. (Given what is likely to happen to food and fuel prices, what would then have to be the path of commodity prices, service prices, wages and fringes, etc., to achieve various degrees of deceleration.)

C. We would seek agreement for COWPS, and other government officials, to meet with particular firms and labor leaders, well in advance of price or wage actions, to discuss the implications of deceleration for them. (For example, auto companies have had price increases of 6 percent a year for two years; we would talk with them early in 1978 on the possibilities of having a smaller price increase for their 1979 models; what would they have to do; could we help. We would discuss with Fitzsimmons and Fraser during 1978 the economic framework for the 1979 Teamsters and UAW negotiations, etc.)

D. We would seek public endorsement from business and labor for these procedures.

3. Federal Government actions

A. We would, in line with deceleration policy, submit a Federal pay raise next year less than this year's 7 percent. Something like 6 percent would be appropriate.

B. We would strengthen and give top level attention to the procedures which you recently approved to subject major cost-raising regulations to an economic review.

C. Securing passage of hospital cost containment would continue to get very high priority.

4. What to project in the budget about the rate of inflation

The economic forecasts in this memo reflect our best judgment on inflation rates in the absence of a successful deceleration program.

We have a dilemma: On the one hand, we have no assurance that a program of the sort outlined above will have a major effect. On the other hand, to make an appeal for deceleration, while projecting budget and economic results on the absence of deceleration, looks like we are admitting failure in advance.

Projecting moderate success in deceleration will reduce our estimates of budget revenues, and increase the budget deficit for 1979 and 1980. The range of estimates is shown below for the large tax cut (Package 2) option:

	1978	1979	1980	1981
Inflation rate				
. as forecast above	6.3	6.4	6.7	6.3
. with moderate success in deceleration	5.9	5.6	5.3	5.0
Budget deficit				
. as forecast above	-56	-65	-39	-20
. with moderate success in deceleration	-56	-66	-43	-23

Since OMB needs a final economic forecast by Wednesday of this week -- to complete their budget work -- we have to make a decision. We shall discuss this with you at our meeting.

5. What we publish in the Budget document

It is traditional, in the January budget, to publish budgetary results for the current budgetary year and the new one (FY 1978 and 1979), and to publish economic results for the two related calendar years (CY 1978 and 1979) based on forecasts of what is likely to happen to the economy.

It is also traditional to publish projections of the economy for the succeeding three years (CY 1980, 1981 and 1982) based on reasonable targets for the economy. Budgetary projections are also traditionally extended for another four years -- 1980 through 1983 -- based on extrapolating outlays from the 1979 budget decisions, and the revenues associated with the economic growth targets.

This traditional approach assumes that the economy can return to a high employment track, without asking whether existing and currently proposed policies are sufficient to keep the economy on that track in the later years. Under this approach, for example, we would not show a 1981 tax cut, but would show a continuing decline in unemployment.

If we follow this approach, however, we face a difficulty: it would show a budget in balance or in small surplus in 1981, but with an unemployment rate that most observers would believe achievable only with additional tax cuts in 1980 or 1981, leading to a 1981 budget deficit. There could be a substantial credibility problem.

footnote would describe option of additional tax cuts if advisable

One way out would be to publish projections along the traditional line, but candidly admit that the economic targets are unlikely to be achieved without further fiscal action in the years ahead. This would clearly imply the likelihood of a budget deficit in 1981.

APPENDIX

Assumptions Underlying the Forecasts

1. Fiscal Policy

    a) Social security taxes -- the Conference Committee compromise bill is incorporated.

effect? b) Energy -- the Administration's energy program is assumed.

COET $2 1/2 B.il   5% = $28.1 drag

2. Monetary Policy

    a) In the base case, the 3-month Treasury bill rate is assumed to rise to 6-3/4 percent by mid-1978 and level out at that rate.

    b) In the forecasts incorporating the larger tax cuts, monetary policy is assumed to accommodate partially the added fiscal stimulus. The bill rate rises to around 7 percent by late 1979.

3. Food Prices

Assumed to increase 4-1/2 percent at retail in 1978 and to increase in line with prices of nonfood commodities thereafter.

4. Foreign Sector

effect? a) OPEC oil prices increase 5 percent in 1978, 7 percent in 1979, and 8 percent in 1980 and 1981.

    b) Real growth in OECD countries other than the United States picks up to a 4 percent rate in 1978 and a 5 percent rate in 1979.