**Democratic Forum on the Economy**

**"Addressing America's Economic Challenges in the Wake of Hurricane Katrina"**

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Washington, DC

September 23, 2005

Thank you for the opportunity to testify before you this morning. As you know, I testify as a Republican—I have served in senior political positions in Ronald Reagan's White House and George H.W. Bush's Treasury Department, and as executive director of the Joint Economic Committee, a cosponsor of this hearing. However, I do not represent the Republican Party or any organization with which I may be associated. I am here speaking only for myself.

I testify as someone who is very disenchanted with his party's fiscal policy since 2001. Unlike the other witnesses, I am less concerned about the deficit per se or about the size of the tax cuts enacted over the last five years. Rather, what really bothers me is the increase in spending and expansion of government that my party has been responsible for.

I used to believe that the Republican Party was the party of small government. That's why I became a Republican. I don't believe that the federal government has the right to one penny more than absolutely necessary to fulfill its essential functions as

spelled out in the Constitution. I think government is over-intrusive and could do what it has to do far more efficiently and at lower cost, which means with lower taxes.

Therefore, it bothers me a great deal when Republicans initiate new entitlement programs, massively expand pork-barrel spending, and show the most callous disregard for fiscal integrity. Not too many years ago, Ronald Reagan vetoed a politically popular highway bill because it contained 157 pork-barrel projects. The latest bill contained at least 5,000. Yet President Bush signed this $295 billion bill into law, despite having promised repeatedly to veto a bill larger than $256 billion.

For the life of me, I cannot understand why President Bush seems so incapable of using his veto pen. His father knew how to veto bills. He vetoed 29 of them in his four years in office. But in his first four-plus years, this President Bush has vetoed nothing. He is the first president since John Quincy Adams to serve a full term without vetoing anything. Curiously, Adams is also the only other son of a former president to become president—and his father, John Adams, didn't veto anything, either.

When I complain about this to the White House, they tell me that it is very hard to veto bills when your party controls both Congress and the White House. But this explanation is simply implausible. Franklin D. Roosevelt had huge Democratic majorities, yet vetoed a record 372 bills. John F. Kennedy, Lyndon Johnson and Jimmy Carter also had large majorities of Democrats, yet Kennedy vetoed 12 bills during his short presidency, Johnson vetoed 16, and Carter vetoed 13.

I won't bore this committee with numbers. You know them as well as I do. Suffice it to say that our fiscal situation is dire and growing worse by the day. My principal concern, however, is not with today's deficits—even if they are swollen by Katrina and Rita-related emergency spending. What worries me is the retirement of the baby boom, the first of which turns 62 in 2008. I'm not saying that we are close to driving off a fiscal cliff, but clearly the implications of this event have not impacted on policymakers in any way whatsoever.

I have struggled with a way to illustrate the consequences of an aging population and its effect on the budget. This is the best I have been able to do. Social Security's unfunded liability comes to 1.2 percent of GDP in perpetuity (1.4 percent without the trust fund)—about what is raised by the corporate income tax—according to that program's actuaries. The comparable number for Medicare is 7.1 percent of GDP—about what is raised by the individual income tax. And remember that these figures are for the unfunded portion of these programs, so they are over and above payroll taxes.

The chilling conclusion, therefore, is that virtually 100 percent of all federal taxes, on a present value basis, do nothing but pay for Social Security and Medicare. Unless there are plans to abolish the rest of the federal government, large tax increases are inevitable.

Let me be clear that I am no advocate of higher taxes. I'm the one who drafted the Kemp-Roth bill back in the 1970's and I have spent most of my career looking for ways to cut tax levels and tax rates. But that was predicated on an assumption those supporting tax cuts also wanted to downsize government. I never saw tax cuts as a substitute for spending cuts, but more as sugar to make the medicine go down. My ultimate goal was to reduce both taxes and spending.

Unfortunately, few in my party seem to share this philosophy any longer. For many, tax cuts have become a substitute for spending cuts. It truly amazes me how often I hear people on my side talk about cutting taxes as if this is the only thing necessary to downsize government. They seem genuinely oblivious to the fact that the burden of government is largely determined by the level of spending, not taxes. Nor do they understand that in the long-run, all spending must be paid for one way or another. Increasing spending today, therefore, absolutely guarantees that taxes will have to be raised in the future.

I am often criticized by friends on my side of the aisle for implicitly endorsing tax increases. I do no such thing. I am simply adding two and two and getting four while my friends seem to think there is some way of only getting three.

They also criticize me for implicitly abandoning the fight to cut spending and downside government. Again, I plead innocent. It is not I who has abandoned the fight, but my party. I don't need to remind anyone here that the biggest spending increases in

recent years passed Congresses with Republican majorities largely without Democratic votes. Nor do I need to remind anyone here that during the Clinton years we not only went from budget deficits to budget surpluses, but did so to a large extent by cutting spending—something my conservative friends seldom acknowledge.

Here's the basic accounting. Defense spending fell by 1.4 percent of GDP between 1993 and 2000, and domestic discretionary spending fell from 3.8 percent to 3.3 percent. Even spending on entitlements fell for temporary demographic reasons, from 10.2 percent of GDP to 9.8 percent. Finally, interest on the debt fell, largely because of falling interest rates, from three percent of GDP to 2.3 percent. The result was an overall decline in spending of three percent of GDP, from 21.4 percent to 18.4 percent, the lowest level since 1966, before the Great Society geared up.

On the revenue side, individual income taxes rose by 2.5 percent of GDP, mainly as the result of rising incomes that pushed people up into higher tax brackets and higher capital gains taxes from the booming stock market. Corporate income taxes and payroll taxes added another 0.8 percent, for a total revenue increase of 3.3 percent of GDP. Thus lower spending and higher revenues constituted a fiscal turnaround of 6.3 percent of GDP, which explains how a deficit of 3.9 percent of GDP in 1993 became a budget surplus of 2.4 percent by 2000.

I don't give President Clinton full credit for this performance. I think most of the credit goes to gridlock. Mr. Clinton wouldn't support the Republican Congress's

spending and it wouldn't support his. So for a blessed six years, government effectively was on automatic pilot. Sadly, unified government has led to an utter lack of restraint by my party that is simply inexcusable. It is extremely dismaying for me to hear House Majority Leader Tom Delay say that there is no fat in the budget and that Republicans have cut it to the bone. This is, quite frankly, ludicrous. My real fear, however, is that he may actually believe it.

I remain convinced that given the total lack of fiscal responsibility demonstrated by the Republican Party that very large tax increases are inevitable. I believe that the fiscal hole is now so large that it is unrealistic to think that we can just tinker with the tax system, as we did so often in the 1980's, and raise enough revenue to pay for spending commitments that have been made. And under the circumstances, I have no faith whatsoever that spending will be significantly restrained—at least not by my side. They would first have to admit error and beg for forgiveness from people like me, something I don't expect to be forthcoming any time soon.

Therefore, like it or not, we must travel the same route taken by the Europeans, who long before us made peace with the welfare state and tried to figure out how to pay for it with the least negative impact on economic growth and incentives. They all imposed a broad-based consumption tax called the value-added tax as an add-on tax to all the others. I think it is only a matter of time before we are forced to do the same thing and the longer we wait the more painful it will be when it is finally done. Unfortunately, we are more than likely going to have to be forced into it by a financial crisis of some

sort. It would be better to avoid that cost and deal with our fiscal situation rationally. But I see no leadership on either side that would allow that to happen.

I don't know when, where or how a financial crisis will develop. I only know that trends that can't continue don't. Since it is unlikely that the vast fiscal imbalance will be resolved with a whimper, it becomes a certainty that it will end with a bang. Among the areas ripe for triggering a crisis are a popping of the housing bubble, a crash of the dollar, a mistake by some big hedge fund, excessive tightening by the Fed and others too numerous to mention. It will take extraordinary luck and skill to avoid every boulder in the stream and I have little confidence that this administration has the personnel to even give us a fighting chance. There are too many Michael Browns at senior levels of the government today and too few Bob Rubins or Alan Greenspans.

Contrary to popular belief, I don't think the American people are a bunch of children who only want hand-outs from the government and will only reward the party that promises them something for nothing. Experience and academic research confirm that they are more likely to support the candidate who treats the public purse with prudence and trust and not as a piggy bank to be routinely broken on a whim. In short, I think there is a political market for the party and the candidate who speaks honestly about the nature of the fiscal crisis that is looming. The payoff may not be immediate and the public trust has to be earned by more than just rhetoric. But if, as I believe, some event will eventually change the political landscape, voters will remember who spoke the truth and who mouthed the platitudes.

It's dirty work, but someone has to do it. Since my party won't do it, yours is going to have to. If it's done right, your party will gain at the expense of mine and you will deserve the benefits and my party will deserve the electorate's disdain.

Appendix

**Legislated Tax Changes by Ronald Reagan as of 1988**

| **Tax Cuts** | **Billions of Dollars** |
|---|---|
| Economic Recovery Tax Act of 1981 | -264.4 |
| Interest and Dividends Tax Compliance Act of 1983 | -1.8 |
| Federal Employees' Retirement System Act of 1986 | -0.2 |
| Tax Reform Act of 1986 | -8.9 |
| Total legislated tax cuts | -275.3 |

| **Tax Increases** | **Billions of Dollars** |
|---|---|
| Tax Equity and Fiscal Responsibility Act of 1982 | +57.3 |
| Highway Revenue Act of 1982 | +4.9 |
| Social Security Amendments of 1983 | +24.6 |
| Railroad Retirement Revenue Act of 1983 | +1.2 |
| Deficit Reduction Act of 1984 | +25.4 |
| Consolidated Omnibus Budget Reconciliation Act of 1985 | +2.9 |
| Omnibus Budget Reconciliation Act of 1985 | +2.4 |
| Superfund Amendments and Reauthorization Act of 1986 | +0.6 |
| Continuing Resolution for 1987 | +2.8 |
| Omnibus Budget Reconciliation Act of 1987 | +8.6 |
| Continuing Resolution for 1988 | +2.0 |
| Total legislated tax increases | +132.7 |

Source: Budget of the United States Government for Fiscal Year 1990

THE NEW YORK TIMES **OP-ED** THURSDAY, JULY 1, 2004

# Those Were the Days

By Bruce Bartlett

GREAT FALLS, Va.

The death of Ronald Reagan led many of his liberal opponents to reassess his presidency, with some concluding that it was better than they thought at the time. The publication of Bill Clinton's memoir, meanwhile, has led many conservatives to reassess his presidency — and most have concluded that it was as awful as they remembered.

If they were honest with themselves, however, conservatives would view the Clinton presidency the same way many liberals now view the Reagan years. Just as Ronald Reagan was not as bad as many liberals thought, neither was Bill Clinton as bad as many conservatives think.

Like most conservatives, I thought Bill Clinton was a terrible president when he was in office. Especially after the Republicans won control of Congress in 1994, we all dreamed of the paradise that would be ours if we could just get a Republican in the White House. We could fix the budget and the tax system, rein in the bureaucracy, neuter the trade unions and trial lawyers, and do all those other things that could never be done because Democrats were always blocking the way.

It was foolish to think like this, of course, just as it is foolish for Democrats to think that every mistake President George W. Bush has made would have been avoided if Al Gore had won in 2000. Circumstances beyond any president's control determine much of what he does in office. If Mr. Gore had won, there would have still been a recession in 2001 that would have caused much of the surplus to disappear, even if there had been no tax cuts. And in all likelihood, the attacks on the World Trade Center would have happened, too.

Yet presidents are not impotent. Sometimes their impact comes from what they don't do, rather than what they do. Sometimes the most important thing a president can do is resist the demand or temptation to act when the right course is to do nothing. And sometimes a president is forced to do things against his will. In the end, however, a president can be judged only by what actually happens on his watch; not by what he thought or intended or by what he might have done but wasn't able to.

**Clinton was a better president than most conservatives admit.**

On this basis, conservatives should rethink the Clinton presidency. At least on economic policy, there is much to praise and little to criticize in terms of what was actually done (or not done) on his watch.

Bringing the federal budget into surplus is obviously an achievement. After inheriting a deficit of 4.7 percent of gross domestic product in 1992, Mr. Clinton turned this into a surplus of 2.4 percent of G.D.P. in 2000 — a remarkable turnaround that can be appreciated by realizing that this year's deficit, as large as it is, will reach only 4.2 percent of G.D.P., according to the Congressional Budget Office.

More important, from a conservative point of view, Mr. Clinton achieved his surplus in large part by curtailing spending. Federal spending fell to 18.4 percent of G.D.P. in 2000 from 22.2 percent in 1992. Although he raised taxes in 1993, he cut them in 1997. He even reduced the capital gains tax — something his predecessor, George H. W. Bush, tried but failed to accomplish.

Although much of the budgetary savings came from lower defense spending and reduced interest on the debt, entitlement spending also fell to 10.6 percent of G.D.P. in 2000 from 11.5 percent in 1992. Mr. Clinton signed welfare reform into law in 1996, the only time in American history when an entitlement program was abolished. By virtually all accounts, welfare reform has been a success.

Mr. Clinton was also steadfast in his support for free trade. It is doubtful that anyone else could have persuaded Congress to approve the North American Free Trade Agreement. On monetary policy, he reappointed Alan Greenspan, a Republican, as chairman of the Federal Reserve, thereby helping to bring inflation down to its lowest sustained level in a generation.

By contrast, Mr. Clinton's Republican successor has caused the surplus to evaporate, raised total federal spending by 1.6 percent of G.D.P., established a new entitlement program for prescription drugs and adopted the most protectionist trade policy since Herbert Hoover. While President Bush has done other things that conservatives view more favorably, like cutting taxes, there is no getting around the reality that Mr. Clinton was better in many respects.

The fact that Mr. Clinton accomplished conservative objectives against his will in some cases, and in others only because a Republican Congress prevented him from enacting more liberal reforms, is beside the point. What matters is what actually was accomplished while Mr. Clinton was in office. On that score, he did much that conservatives should approve of. □

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